

Stock Update

ZF Steering Gear (India) Ltd.

October 13, 2023





ZF Steering Gear (India) Ltd.

| Industry | LTP | Recommendation | Base Case Fair Value | Bull Case Fair Value | Time Horizon |
|------------------|--------|---|----------------------|----------------------|--------------|
| Auto Ancillaries | Rs 774 | Buy in Rs 768-784 band and add on dips in Rs 695-710 band | Rs 845 | Rs 910 | 2-3 quarters |

| | |
|------------------------|------------|
| HDFC Scrip Code | ZFSTEZEQNR |
| BSE Code | 505163 |
| NSE Code | NA |
| Bloomberg | ZFSG IN |
| CMP Oct 12, 2023 | 773.8 |
| Equity Capital (Rs cr) | 9.1 |
| Face Value (Rs) | 10 |
| Equity Share O/S (cr) | 0.9 |
| Market Cap (Rs cr) | 702 |
| Book Value (Rs) | 461.6 |
| Avg. 52 Wk Volumes | 14,500 |
| 52 Week High (Rs) | 883.9 |
| 52 Week Low (Rs) | 377.8 |

| Share Holding Pattern % (Sep, 2023) | |
|-------------------------------------|-------|
| Promoters | 67.2 |
| Institutions | 0.0 |
| Non Institutions | 32.8 |
| 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:

ZF Steering Gear (India) Ltd. (ZFI) is a key supplier of steering systems to the CV and tractor segments of the automobile industry. Overall, the domestic M&HCV and tractor steering systems market is primarily duopolistic, with ZFI and the Rane Group driving ~90% of the market share. The use of power steering in M&HCV and tractors has been increasing over the years due to the need and ease of use for the driver of the vehicle. Further the cost of power steering as compared to the total vehicle cost has come down significantly resulting in higher adoption by companies.

The Indian CV cycle has witnessed strong growth in FY23 and expected to grow in the range of 2-4% in FY24. Higher utilization of capacities would lead to better operating leverage and margin expansion for the company. ZFI has also taken steps for backward integration. It has incorporated two wholly owned subsidiaries and land has also been allotted. Better cost control over input would further add to the margins.

On October 3, 2022, we had initiated coverage on the stock ([Link](#)) with a recommendation to 'Buy in Rs 540-550 band and add on dips in Rs 480-490 band' for base case fair value of Rs 611 and bull case fair value of Rs 649 over next 2-3 quarters. Both the targets were achieved within the given time frame.

Valuation & Recommendation:

We expect ZFI's Revenue/EBITDA/PAT to grow at 12/22/39% CAGR over FY23-FY25E, led by the improvement in demand scenario for CV and tractors. We expect EBITDA margin to expand by ~250bps to ~15% and RoE to increase from ~6% in FY23 to ~10% by FY25E. We believe investors can buy the stock in the band of Rs 768-784 and add on dips in Rs 695-710 band (13.5x FY25E EPS) for a base case fair value of Rs 845 (16.25x FY25E EPS) and bull case fair value of Rs 910 (17.5x FY25E EPS) over the next 2-3 quarters.



Financial Summary

| Particulars (Rs cr) | Q1FY24 | Q1FY23 | YoY (%) | Q4FY23 | QoQ (%) | FY22 | FY23 | FY24E | FY25E |
|---------------------|--------|--------|---------|--------|---------|-------|-------|-------|-------|
| Operating Income | 120.9 | 110.3 | 9.6 | 125.1 | -3.4 | 312.8 | 450.4 | 491.6 | 562.4 |
| EBITDA | 18.4 | 18.4 | 0.2 | 15.9 | 16.0 | 40.6 | 55.9 | 71.3 | 83.8 |
| APAT | 12.0 | 5.0 | 139.4 | 10.1 | 19.0 | 18.3 | 24.5 | 35.6 | 47.2 |
| Diluted EPS (Rs) | 13.2 | 5.5 | 139.4 | 11.1 | 19.0 | 20.1 | 27.1 | 39.3 | 52.0 |
| RoE (%) | | | | | | 4.7 | 6.0 | 8.2 | 10.1 |
| P/E (x) | | | | | | 38.4 | 28.6 | 19.7 | 14.9 |
| EV/EBITDA (x) | | | | | | 17.8 | 13.2 | 10.5 | 8.8 |

(Source: Company, HDFC sec)

Q1FY24 Result Update

Q1FY24 witnessed decent topline growth 9.6% YoY. Net sales increased to Rs 121cr as compared to Rs 110cr in corresponding quarter last year as CV volumes remained robust. Sequentially sales increased 3.4% QoQ. EBITDA was up 0.2%/16.0% YoY/QoQ to Rs 18cr as raw material inflation moderated QoQ resulting in 360bps expansion in gross margins. EBITDA margin contracted 140bps Yoy while sequentially in expanded 250 bps to 15.2%. PAT grew 139% YoY as MTM reporting of investments led to a profit of Rs 7cr against a loss of Rs 3cr in Q1FY23. Tax expenses amounted to 32% of PBT as compared to 42% in Q1FY23. Sequentially PAT grew 19% to Rs 12cr.

Key Triggers

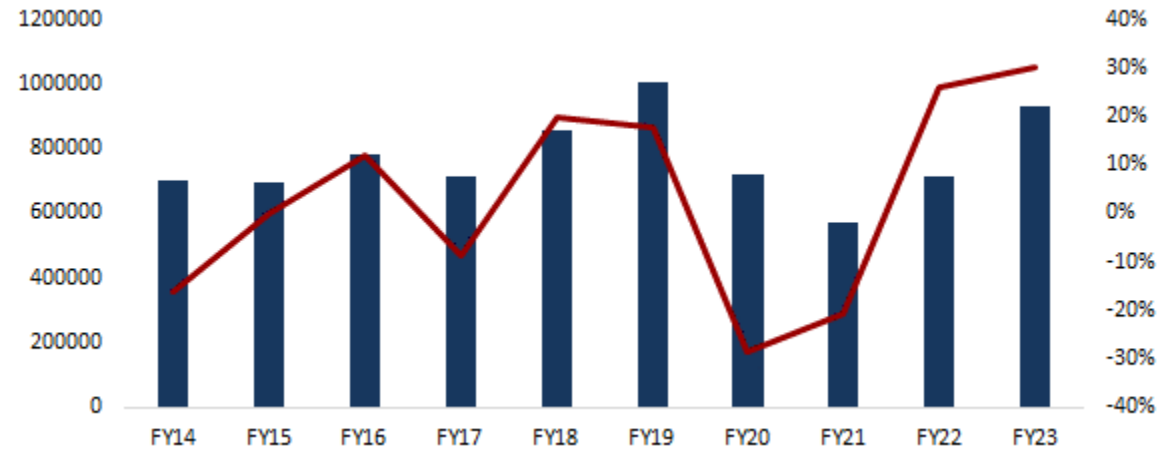
CV sales growth to moderate in FY24

After sluggish 5-months of FY24, CV sales have started to witness some momentum. The Indian commercial vehicle (CV) industry registered a growth of 14.7% in domestic wholesale volumes on a sequential basis and 11.7% on a YoY basis in September 2023. For H1 FY24 (April-September), the domestic CV industry reported a YoY growth of 2.4% in wholesale volumes.

ICRA expects the CV industry wholesale volumes to remain firm during the rest of the year, supported by steady freight demand during the upcoming festive period, economic recovery and the Government's focus on infrastructure spending in line with the budgetary allocations. It expects the industry to report volume growth of 2-4% in wholesale dispatches in FY24 to 0.98-1 million. The growth in FY2024 would follow a year of healthy demand in FY2023, wherein the industry volumes expanded by more than 30%, supported by a favourable base, as well as a healthy pick-up in macroeconomic activity.



CV Sales trend



(Source: Company, HDFC sec)

Backward integration to reduce manufacturing costs

ZFI has incorporated, in April 2022, two Wholly-Owned Subsidiaries, as a step towards backward integration for production of some of the key components, required for its end product i.e. Steering Gears. Names of the Wholly-Owned Subsidiaries (WOS) are:

- i. DriveSys Systems Private Limited
- ii. NexSteer Systems Private Limited

Both these companies have acquired and taken possession of industrial land at Maharashtra Industrial Development Corporation (MIDC) Supa Parner Industrial Park, Ahemdagar, Maharashtra. The construction activities for the factory shed of both the companies situated at the above locations are in progress. DriveSys has ordered major machinery for its business operations. These companies are expected commence operations by last quarter of the current Financial Year.

The Company has so far invested Rs 8cr in DriveSys and Rs 8 lakh in NexSteer by way of subscription to the equity share capital of these companies. Total capital outlay to be made on the above projects will be in vicinity of Rs 100cr. This would give the company better control over costs and increase the total kit value.



Strong position in domestic steering systems industry for M&HCVs and tractors

The Indian steering gear market is primarily dominated by three major players—viz., JTEKT India Limited (erstwhile Sona Koyo Steering Systems Limited), Rane TRW Steering Systems Private Limited and ZFI. While JTEKT is primarily present in the passenger vehicle (PV) segment, ZFI and Rane Group are mainly present in the CV and tractor segments. Overall, the domestic M&HCV and tractor steering systems market is primarily duopolistic, with ZFI and the Rane Group driving ~90% of the market share.

Margin expansion on increased capacity utilization

The uptick in CV cycle has led to higher demand for company's products resulting in better capacity utilization. Higher operating leverage would lead to operating margin expansion. Current demand revival will have superior impact on margins as company has reduced fixed and power (own windmill) costs materially which will pay-off in up cycle.

Steering industry overview

According to a report by Mordor Intelligence, the Automotive Steering Market was valued at USD 27 billion in 2022 and is expected to reach USD 38 billion over the next five years, growing at a CAGR of more than 5.5%. Over the long term, the increasing use of steering-mounted electronics, which makes it more intuitive, is one of the main factors driving the growth of the automotive steering market. Over the last two decades, steering has been used to control various automobile dashboard-based functions and with technological developments many of these uses is likely to flow in CV steering as well. Electric power system and Hydraulic power system accounting for ~80-85% of the total market. Manual steering application used in tractors, 3W and construction equipments, etc. accounts for rest of the market. While electric power steering is predominantly used in the passenger car, Hydraulic power steering system is used in high powered engine UV and CV segments. Key players operating in the market include ZF Commercial Vehicle, Rane Holdings, JTEKT Corporation, Mando Corporation, Knorr-Bremse, ZF Steering, Nexteer Automotive Group, Bosch Auto Parts, Thyssenkrupp Business Area Components Technology, and Denso.

Risk & Concern

Vulnerable to cyclicity in demand from CV/Tractor OEMs

ZFI primarily supplies its steering system to CV/Tractor manufacturers and is exposed to the cyclicity in them. Volumes may remain partly constrained due to the continuing supply challenges in semiconductors and also the sharp increase in retail fuel prices.

Elevated commodity and fuel prices

Elevated commodity prices and rising fuel costs are impacting the cash flows of truck operators. As petrol and diesel prices have risen significantly in the past year it may impact demand if truck operators are not able to pass on the increased cost. Rising commodity prices could force ZFI to either increase its selling prices or absorb the higher costs.



Increasing vehicle prices

Vehicle prices have increased to accommodate rising commodity prices and regulatory requirements, especially emission norms. Further tightening of emission norms for tractors and CV would drive prices even higher.

Rising competition

The existing players may up their ante or new players may enter the space raising competition concerns for ZFI.

Low return ratios

ZFI earned low return ratios from FY19 to FY22 due to low PAT margins, low leverage and limited sales to fixed assets ratio. With higher capacity utilization we expect return ratios to improve in the coming years.

Litigation by ZF group

ZFI received a communication from ZF Friedrichshafen AG (ZF AG) in relation to infringement of trademark “ZF” and/or “ZF India. Amongst other things ZF AG has allegedly demanded a sum of Rs 100cr in damages from the Company and also provided an option to the Company to meet and discuss the matter. The Authorised representatives of ZFI did have discussions with ZF AG on without prejudice basis. However ZF AG abruptly closed negotiation / discussions. ZFI has filed commercial suits before Honble District Court of Pune on June 30 2023.

Company Background:

ZF Steering Gear (India) Ltd. (ZFI) was incorporated in the year 1981 as a joint venture ZF Friedrichshafen AG. Later, Robert Bosch Automotive Steering GmbH acquired ZF Lenkystene GmbH and renamed the company as Robert Bosch Automotive Steering GmbH. It is a pioneer in manufacturing and supply of Ball and Nut Integral Hydraulic Power & Worm and Roller Mechanical Steering System in India. Its plant is located at Shirur district near Pune, which is a major automotive hub with OEM like Force Motors, General Motors, Mercedes Benz, Mahindra Trucks & Bus Ltd, TATA Motors, etc. Present installed capacity of the plant is 2,00,000 units of Worm and Roller Mechanical Steering Gears and 3,75,000 units of Ball and Nut Integral Hydraulic Power Steering Gears. Robert Bosch Automotive Steering GmbH sold its 25.8% stake in ZFI to the Indian promoters in the March 2023 quarter, thus exiting the company.

ZFI’s valuable customers are:

| Power Steering Gears | Mechanical Steering Gears |
|---|------------------------------------|
| Ashok Leyland Ltd. | Action Construction Equipment Ltd. |
| Daimler India Commercial vehicles Pvt. Ltd. | Bajaj Auto Ltd. |
| Force Motors Ltd. | Escorts Ltd. |
| KAMAZ Motors Ltd. | Force Motors Ltd. |
| Mahindra Trucks & Buses Ltd. | International Tractors Ltd. |

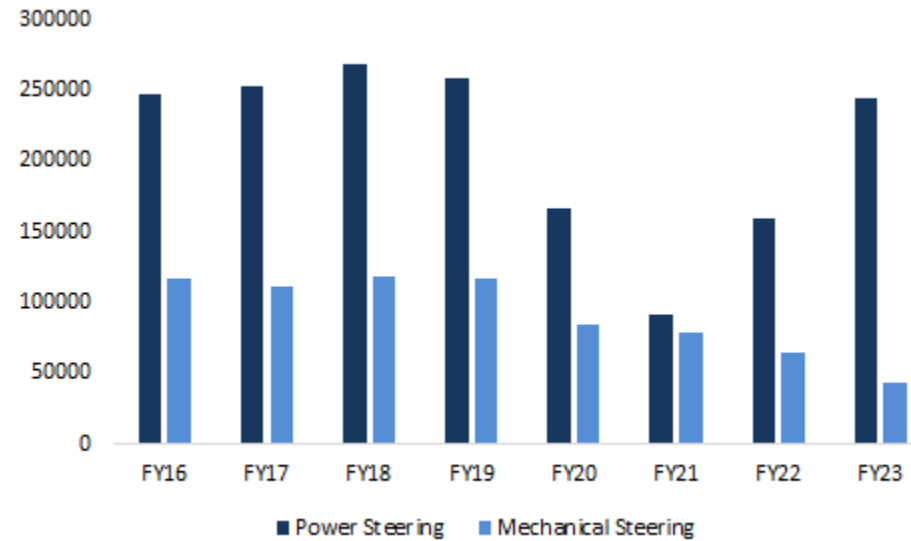


ZF Steering Gear (India) Ltd.

| | |
|--|---|
| MAN Trucks India Pvt. Ltd SML Isuzu Ltd Tata Motors Ltd. VE Commercial Vehicles Ltd. Volvo Group Captain Tractors | Mahindra & Mahindra Ltd. New Holland Fiat india Pvt. Ltd. Piaggio vehicles Private Ltd. Same Deutz-Fahr India Private Ltd. TAFE Motors & Tractors Ltd. Universal Construction Machinery Mahindra and Mahindra --Swaraj Tractors Preet Tractors--Punjab |
|--|---|

The company's steering gears are supplied to various CV manufacturers, as well as to heavy vehicles like dumpers and haulage trucks. ZFI has state of the art technology in Design & Manufacturing various types of Power Steering Systems and Mechanical Steering Systems based on customer needs. It is continuously in the process of widening its product base to meet the increasing demands of automotive market and is keen to diversify in appropriate product lines.

Split of power and mechanical steering sales



(Source: Company, HDFC sec)



Financials

Income Statement

| (Rs cr) | FY21 | FY22 | FY23 | FY24E | FY25E |
|--------------------------|---------------|--------------|--------------|--------------|--------------|
| Net Revenues | 201.5 | 312.8 | 450.4 | 491.6 | 562.4 |
| Growth (%) | -29.7 | 55.3 | 44.0 | 9.1 | 14.4 |
| Operating Expenses | 183.2 | 272.2 | 394.5 | 420.3 | 478.6 |
| EBITDA | 18 | 41 | 56 | 71 | 84 |
| Growth (%) | -153.9 | 122.2 | 37.7 | 27.5 | 17.6 |
| EBITDA Margin (%) | 9.1 | 13.0 | 12.4 | 14.5 | 14.9 |
| Depreciation | 37.6 | 31.4 | 32.2 | 35.2 | 36.7 |
| Other Income | 26.4 | 21.0 | 13.3 | 17.2 | 21.4 |
| EBIT | 7.0 | 30.2 | 37.0 | 53.3 | 68.5 |
| Interest expenses | 0.3 | 0.3 | 0.7 | 0.9 | 1.1 |
| PBT | 6.8 | 29.9 | 36.3 | 52.4 | 67.4 |
| Tax | -2.1 | 11.6 | 11.8 | 16.8 | 20.2 |
| PAT | 8.8 | 18.3 | 24.5 | 35.6 | 47.2 |
| Exceptional Item | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Adj. PAT | 8.8 | 18.3 | 24.5 | 35.6 | 47.2 |
| Growth (%) | 48.0 | 106.4 | 34.3 | 45.1 | 32.4 |
| EPS | 9.8 | 20.1 | 27.1 | 39.3 | 52.0 |

Balance Sheet

| As at March (Rs cr) | FY21 | FY22 | FY23 | FY24E | FY25E |
|-----------------------------------|--------------|--------------|--------------|--------------|--------------|
| SOURCE OF FUNDS | | | | | |
| Share Capital | 9.1 | 9.1 | 9.1 | 9.1 | 9.1 |
| Reserves & Surplus | 367.6 | 386.0 | 409.6 | 439.8 | 480.6 |
| Shareholders' Funds | 376.6 | 395.1 | 418.7 | 448.8 | 489.7 |
| Total Debt | 31.5 | 27.7 | 38.2 | 61.2 | 51.2 |
| Net Deferred Taxes | -24.6 | -12.9 | -1.5 | -1.5 | -1.5 |
| Other Non-curr. Liab. | 4.2 | 8.6 | 6.2 | 6.7 | 7.7 |
| Total Sources of Funds | 387.8 | 418.5 | 461.6 | 515.3 | 547.1 |
| APPLICATION OF FUNDS | | | | | |
| Net Block & Goodwill | 174.8 | 159.1 | 156.9 | 199.6 | 192.6 |
| CWIP | 2.4 | 2.4 | 7.2 | 4.3 | 2.6 |
| Investments | 120.4 | 118.6 | 148.5 | 148.5 | 173.5 |
| Other Non-Curr. Assets | 8.0 | 18.5 | 25.2 | 27.5 | 31.5 |
| Total Non Current Assets | 305.6 | 298.6 | 337.9 | 379.9 | 400.2 |
| Inventories | 37.6 | 57.5 | 58.2 | 60.6 | 64.7 |
| Debtors | 78.4 | 90.3 | 106.9 | 110.4 | 118.6 |
| Cash & Equivalent | 9.7 | 4.5 | 0.6 | 14.8 | 15.7 |
| Other Current Assets | 10.0 | 8.4 | 6.8 | 10.5 | 12.2 |
| Total Current Assets | 135.7 | 160.7 | 172.4 | 196.4 | 211.2 |
| Creditors | 30.3 | 27.8 | 35.5 | 43.1 | 46.2 |
| Other Current Liab & Provisions | 23.3 | 13.0 | 13.2 | 18.0 | 18.1 |
| Total Current Liabilities | 53.6 | 40.8 | 48.7 | 61.1 | 64.4 |
| Net Current Assets | 82.1 | 119.9 | 123.7 | 135.3 | 146.8 |
| Total Application of Funds | 387.8 | 418.5 | 461.6 | 515.3 | 547.1 |



ZF Steering Gear (India) Ltd.

Cash Flow Statement

| (Rs cr) | FY21 | FY22 | FY23 | FY24E | FY25E |
|----------------------------------|--------------|--------------|--------------|--------------|--------------|
| Reported PBT | 6.8 | 29.9 | 36.3 | 52.4 | 67.4 |
| Non-operating & EO items | -23.4 | -14.1 | -5.3 | -1.7 | -3.0 |
| Interest Expenses | -0.7 | -0.2 | 0.7 | 0.9 | 1.1 |
| Depreciation | 37.6 | 31.4 | 32.2 | 35.2 | 36.7 |
| Working Capital Change | -46.2 | -27.2 | -8.3 | 2.6 | -10.6 |
| Tax Paid | -0.4 | -4.6 | -6.7 | -16.8 | -20.2 |
| OPERATING CASH FLOW (a) | -26.3 | 15.2 | 48.9 | 72.6 | 71.3 |
| Capex | -9.9 | -33.0 | -39.5 | -75.0 | -28.0 |
| Free Cash Flow | -36.2 | -17.8 | 9.4 | -2.4 | 43.3 |
| Investments | 9.6 | 16.2 | -24.0 | 0.0 | -25.0 |
| Non-operating income | 1.3 | 0.7 | 0.9 | 0.0 | 0.0 |
| INVESTING CASH FLOW (b) | 0.9 | -16.2 | -62.6 | -75.0 | -53.0 |
| Debt Issuance / (Repaid) | 26.6 | -2.8 | 12.5 | 23.0 | -10.0 |
| Interest Expenses | -0.2 | -0.3 | -0.7 | -0.9 | -1.1 |
| FCFE | 1.0 | -4.1 | -2.0 | 19.7 | 7.2 |
| Share Capital Issuance | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Dividend | -0.1 | -0.1 | 0.0 | -5.4 | -6.3 |
| Others | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| FINANCING CASH FLOW (c) | 26.3 | -3.2 | 11.7 | 16.7 | -17.4 |
| NET CASH FLOW (a+b+c) | 0.9 | -4.1 | -2.0 | 14.2 | 0.9 |

Key Ratios

| | FY21 | FY22 | FY23 | FY24E | FY25E |
|---------------------------------|-------|-------|-------|-------|-------|
| Profitability Ratios (%) | | | | | |
| EBITDA Margin | 9.1 | 13.0 | 12.4 | 14.5 | 14.9 |
| EBIT Margin | 3.5 | 9.7 | 8.2 | 10.8 | 12.2 |
| APAT Margin | 4.4 | 5.8 | 5.4 | 7.2 | 8.4 |
| RoE | 2.4 | 4.7 | 6.0 | 8.2 | 10.1 |
| RoCE | 1.8 | 7.3 | 8.4 | 11.0 | 13.0 |
| Solvency Ratio (x) | | | | | |
| Net Debt/EBITDA | 1.2 | 0.6 | 0.7 | 0.7 | 0.4 |
| Net D/E | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| PER SHARE DATA (Rs) | | | | | |
| EPS | 9.8 | 20.1 | 27.1 | 39.3 | 52.0 |
| CEPS | 51.2 | 54.8 | 62.5 | 78.1 | 92.5 |
| BV | 415.3 | 435.6 | 461.6 | 494.9 | 539.9 |
| Dividend | 0.0 | 0.0 | 5.0 | 6.0 | 7.0 |
| Turnover Ratios (days) | | | | | |
| Debtor days | 115 | 98 | 80 | 81 | 74 |
| Inventory days | 55 | 55 | 47 | 44 | 41 |
| Creditors days | 58 | 34 | 26 | 29 | 29 |
| VALUATION | | | | | |
| P/E | 79.3 | 38.4 | 28.6 | 19.7 | 14.9 |
| P/BV | 1.9 | 1.8 | 1.7 | 1.6 | 1.4 |
| EV/EBITDA | 39.6 | 17.8 | 13.2 | 10.5 | 8.8 |
| EV / Revenues | 3.6 | 2.3 | 1.6 | 1.5 | 1.3 |
| Dividend Yield (%) | 0.0 | 0.0 | 0.6 | 0.8 | 0.9 |
| Dividend Payout (%) | 0.0 | 0.0 | 18.5 | 15.3 | 13.5 |

(Source: Company, HDFC sec)



ZF Steering Gear (India) Ltd.

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. These 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.



ZF Steering Gear (India) Ltd.

Disclosure:

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Registration granted by SEBI, membership of BASL (in case of IAs) and certification from NISM in no way guarantee performance of the intermediary or provide any assurance of returns to investors.