Sterling Tools

STL to ride on auto industry recovery

Investment Arguments

Recovery in Automobile industry would benefit Sterling Tools (STL): The automobile industry's performance in the past two consecutive years (FY2013 and FY2014) was disappointing. But In YTD FY2015 (April to August), the 2W industry has reported a strong growth of ~17% due to recovery in domestic and export markets and PVs have also shown an ~4% yoy growth. However, the commercial vehicle (CV) segment is still under pressure due to poor performance of light commercial vehicles (LCVs), although early signs of recovery are now visible (since June 2014). Considering overall sales volumes in the past five months, we expect growth momentum to continue and expect the Indian automobile industry to report a healthy ~14% CAGR over FY2014-16E which would benefit auto ancillary companies like Sterling Tools (STL).

Strong customer base would provide revenue visibility for STL: OEMs are a major contributor to STL's revenues (~81%). STL is among the top 3 fastener manufacturers in India, supplying to major OEMs like Honda (STL is the largest supplier of HT fasteners to the company), Maruti Suzuki India and Tata Motors (STL is the second-largest supplier of fasteners to the two companies). STL's other blue chip customers include Ashok Leyland, Daimler, Fiat, Hero Motocorp, Mahindra & Mahindra, Volvo, Eicher, TAFE and General Motors. This gives the company a diversified customer base and positions it for strong growth, driven by the sharp uptick in volume growth across a range of segments in the industry.

Outlook and Valuation: We forecast STL to report a Net Sales CAGR of ~14% over FY2014-16E to ~₹394cr and net profit CAGR of ~20% during the same period to ₹23cr. At the current market price of ₹332, the stock trades at a PE of 12.1x and 10.0x its FY2015E and FY2016E EPS of ₹27.4 and ₹33.1, respectively. **We initiate coverage on the stock with a Buy recommendation and target price of ₹397, based on 12x FY2016E EPS, indicating an upside of ~20% from the current levels.**

Key financials

Y/E March (₹ cr)	FY2013	FY2014	FY2015E	FY2016E
Net sales	283	301	342	394
% chg	*(4.2)*	*6.7*	*13.4*	*15.4*
Net profit	11	16	19	23
% chg	*(26.3)*	*43.6*	*19.8*	*20.8*
EBITDA margin (%)	12.4	13.9	13.9	13.9
EPS (₹)	15.9	22.8	27.4	33.1
P/E (x)	20.8	14.5	12.1	10.0
P/BV (x)	2.5	2.3	2.0	1.7
RoE (%)	12.2	15.5	16.2	16.7
RoCE (%)	15.4	19.5	20.6	21.8
EV/Sales (x)	1.1	0.9	0.8	0.7
EV/EBITDA (x)	8.6	6.7	5.8	5.0

Source: Company, Angel Research, Note: CMP as of September 11, 2014

BUY

CMP	₹332
Target Price	₹397
Investment Period	12 Months

Stock Info	
Sector	Auto Ancillary
Market Cap (₹ cr)	231
Net Debt (₹ cr)	54
Beta	0.6
52 Week High / Low	341 / 93
Avg. Daily Volume	3,117
Face Value (₹)	10
BSE Sensex	26,996
Nifty	8,086
Reuters Code	STTL.BO
Bloomberg Code	STRT@IN

Shareholding Pattern (%)	
Promoters	70.2
MF / Banks / Indian FIs	0.3
FII / NRIs / OCBs	0.0
Indian Public / Others	29.5

Abs. (%)	3m	1yr	3yr
Sensex	6.0	35.0	60.1
STL	68.1	242.3	204.6

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Investment Arguments

Recovery in Automobile industry would benefit STL

During YTD FY2015 (April to August), the 2W industry has reported a strong growth of ~17% due to strong recovery in domestic and export markets

India has been amongst the fastest growing automobile markets in the world in the last five years. For FY2014, automobile volumes (2W, commercial vehicles [CVs], passenger vehicles [PVs] and tractors), domestic and exports, stood at ~21.4 million units (a 4.6% yoy growth). The industry has recovered from a subdued volume growth in FY2013, which was owing to a slowdown in the domestic economy, higher inflation and increase in fuel prices. Further, overall automobile export numbers were also subdued. However, in FY2014, the Indian automobile industry showed some recovery in domestic and export sales volumes, mainly driven by the 2W segment.

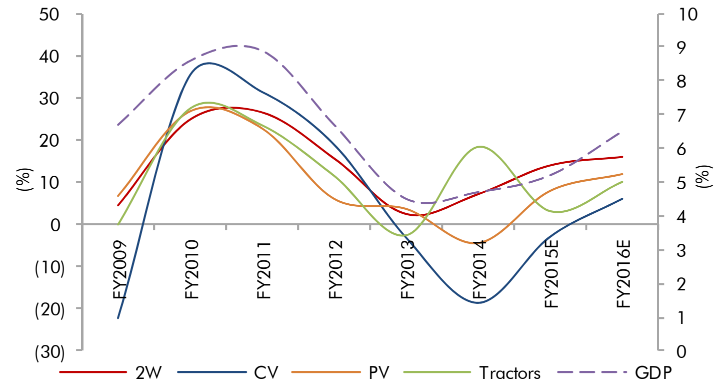
During YTD FY2015 (April to August), the 2W industry has reported a strong growth of ~17% (vs 7.2% yoy growth in FY2014). PVs have also shown an ~4% yoy growth (vs a degrowth of 4.4% in FY2014) due to recovery in domestic and export markets. However, the CV segment is still under pressure due to poor performance of LCVs. Nonetheless, the MHCV segment has also started showing recovery (from June 2014) and going forward we expect CV volumes to be driven by improvement in the Indian economy.

Exhibit 1: Automobile Industry trend

Source: SIAM, Angel Research,

 # Includes data of Two Wheelers, Commercial Vehicle, Passenger Vehicle and Tractors

Exhibit 2: GDP & Automobile Industry growth projection



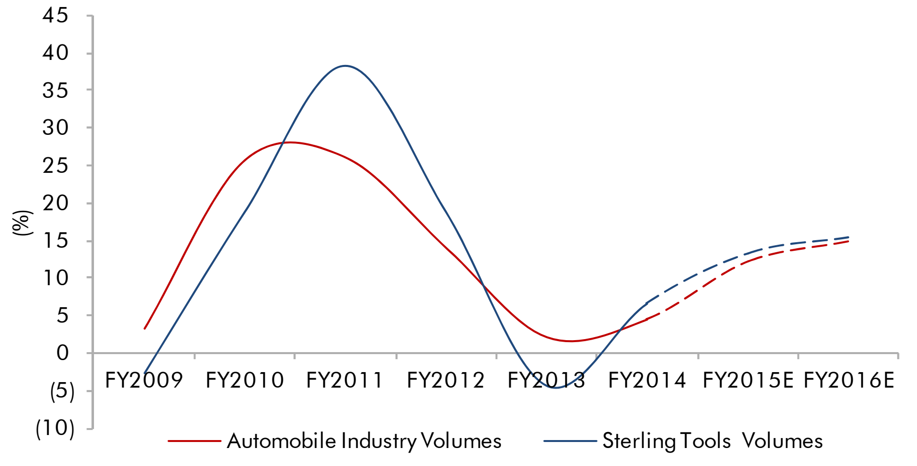
Source: SIAM, Angel Research

We expect the Indian automobile industry to report a healthy ~14% CAGR over FY2014-16E

Considering the overall improvement in demand in the domestic and export markets with Indian automobile OEMs expanding presence in new geographical regions in the last three quarters, we expect the Indian automobile industry to report a healthy ~14% CAGR over FY2014-16E. Also, with the formation of the new government at the centre, we expect inflationary pressures to subside, thus leading to lower interest rates.

This coupled with the anticipation of an increase in personal disposable incomes due to recovery in the domestic economy would create a positive sentiment for Indian consumers, and in turn lead to an improvement in 2W and PV volumes. Further, we expect improvement in GDP growth (in 1QFY2015 India's GDP growth was 5.7%, which is the highest in the last nine quarters) in FY2015 and FY2016; this would assist growth in the CV segment, mainly in the LCV segment, which is currently underperforming.

Exhibit 3: Correlation bet. Automobile vol. and STL's vol. performance



Source: Company, Angel Research

2Ws and CVs account for the largest chunk of STL's sales (21% each), followed by PVs at 11%, farm equipment (tractors) at 10%, replacement segment at 10%, while exports account for 9% of total sales.

STL caters to all segments of the automobile industry. 2Ws and CVs account for the largest chunk of its sales (21% each), followed by PVs at 11%, farm equipment (tractors) at 10%, replacement at 10% while export account for 9% of total sales. Thus, we believe that STL is best placed to take advantage of an expected recovery in the automobile industry.

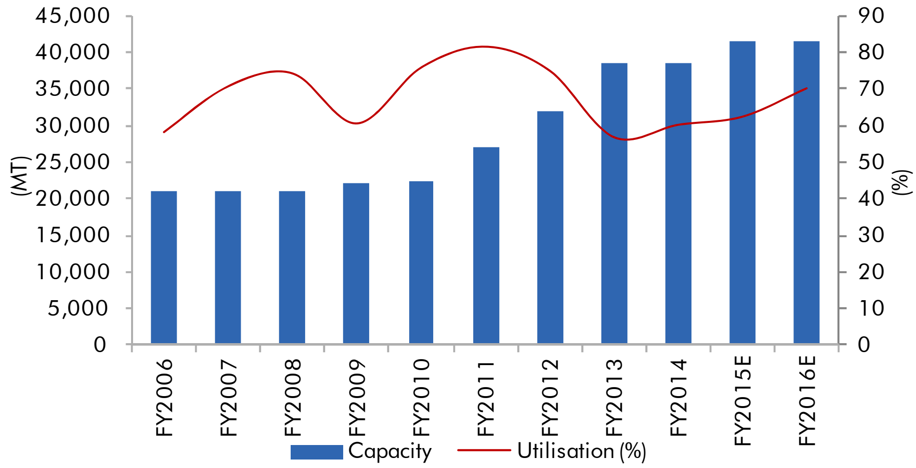
Moreover, over the last six years, we have witnessed a strong correlation between volume growth in the automobile industry and volume growth of STL. We expect this trend to continue going forward. Thus, in our view, STL would benefit from a recovery in the automobile industry going forward.

Consistent capacity expansion will trigger top-line growth

Since FY2006, STL has almost doubled its capacity from 21,000 MTPA to 41,600 MTPA

STL has undertaken several expansions in the past 8-9 years. Since FY2006, it has almost doubled its capacity from 21,000 MTPA to 41,600 MTPA (the company has undergone several periodical upgradations and modernization). Recently the company has increased its manufacturing capacity in the Fasteners segment from 38,400 MT per annum to 41,600 MT per annum (by the end of FY2014) to cater to the increasing demand from the automobile industry. Automobile industry sales volumes have started improving owing to improvement in the demand scenario. Also, the OEMs are increasing their capacity and geographical reach. The enhancement in capacity by STL will enable it to service the increase in demand.

Exhibit 4: Installed Capacity & Utilised Capacity trend



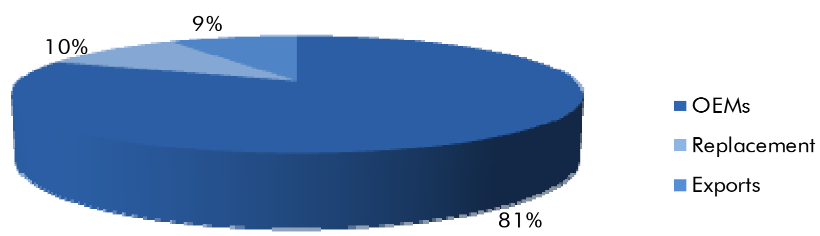
Source: Company, Angel Research

The company's key clients are Honda Motorcycle & Scooters India, Maruti Suzuki India and Tata Motors

Strong customer base would provide revenue visibility for STL

OEMs are a major contributor to STL's revenues (~81%). STL is among the top 3 fastener manufacturers in India, supplying to major OEMs like Honda (STL is the largest supplier of HT fasteners to the company), Maruti Suzuki India and Tata Motors (STL is the second-largest supplier of fasteners to the two companies). STL's other blue chip customers include Ashok Leyland, Daimler, Fiat, Hero Motocorp, Mahindra & Mahindra, Volvo, Eicher, TAFE and General Motors. This gives the company a diversified customer base and positions it for strong growth, driven by the sharp uptick in volume growth across a range of segments in the industry.

Exhibit 5: Break-up of Revenue mix



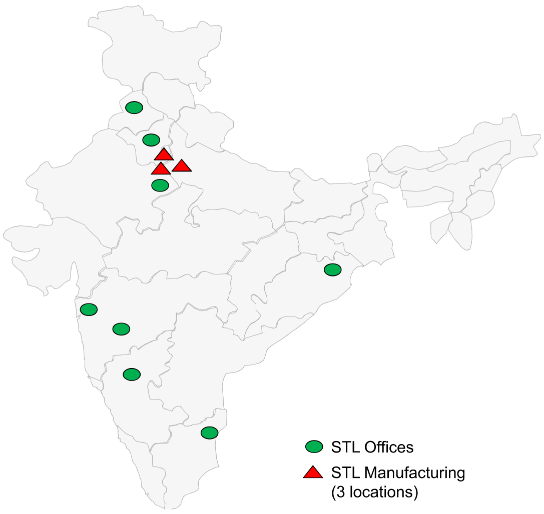
Source: Company, Angel Research

Currently, the company has more than 60 dealers and the number is growing rapidly

Focus on expansion of distribution network

To push replacement market sales, the company is continuously focusing on increasing dealerships for its products. Currently, the company has more than 60 dealers and the number is growing rapidly. With regional offices in both Chennai and Pune and residential representatives in places such as Jamshedpur, Mumbai and many more cities, STL has been able to interact closely with automobile dealers, fleet owners and mechanics. This has helped it to gain a better understanding of their needs and enabled it to serve them better. By further strengthening foothold in this segment, the company intends to make its presence felt in every part of the country.

Exhibit 6: Domestic Network of STL



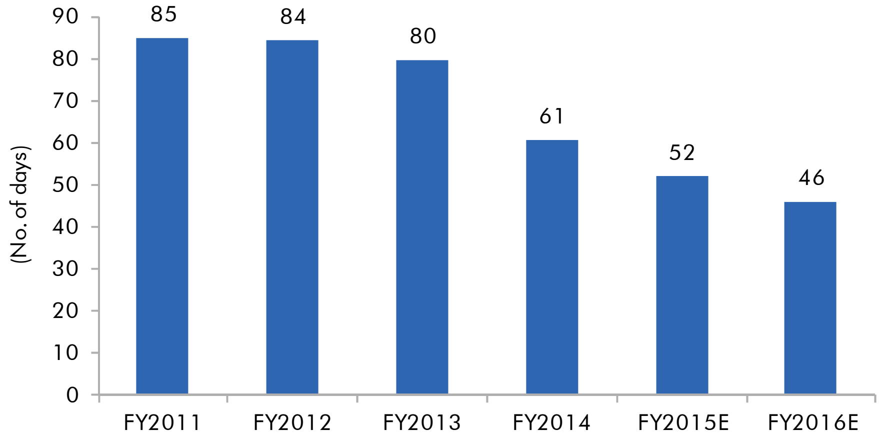
Source: Company, Angel Research

Healthy return ratios, lower D/E and better working capital

The company's working capital cycle has reduced from 85 days in FY2011 to 61 days in FY2014

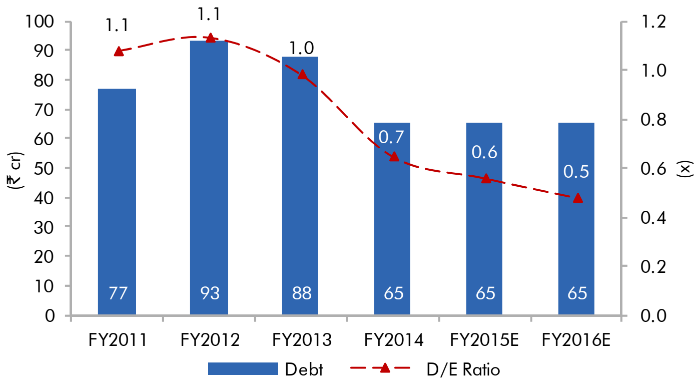
We expect the company to report improvement in its ROE and ROCE on the back of healthy profitability with strong sales, healthy operating margin due to better product mix, higher capacity utilization. A decline in interest expenses would also aid profitability. Further, the company's working capital cycle has reduced from 85 days in FY2011 to 61 days in FY2014. We expect it to come down further, ie in the range of 45-50days, owing to improvement in inventory days and receivable days. Moreover, the company's debt has reduced from ₹93cr in FY2012 to ₹65cr in FY2014 and we do not expect any significant debt raising by the company due to absence of any major capex plans in the near term.

Exhibit 7: Decreasing working capital days



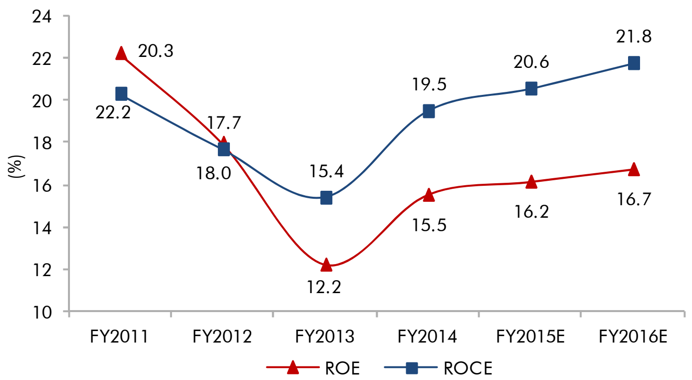
Source: Company, Angel Research

Exhibit 8: Decreasing Debt/Equity ratio



Source: Company, Angel Research

Exhibit 9: Improvement in ROE and ROCE ratios



Source: Company, Angel Research

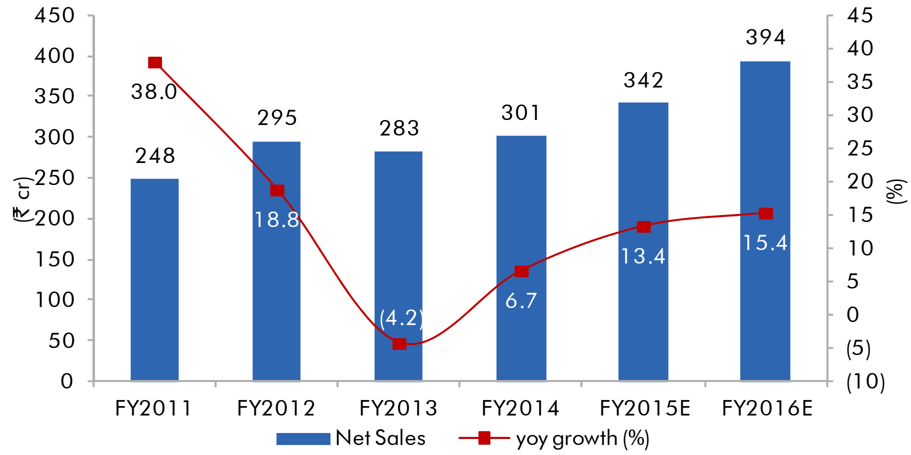
Financial outlook

Top-line likely to clock a CAGR of ~14% over FY2014-16E

Going forward, we expect STL to register a healthy sales CAGR of ~14% over FY2014-16E

STL has reported standalone sales CAGR of ~1% over FY2012-14. During FY2013, the company was unable to perform well due to slowdown in Indian economy and subdued automobile sales volumes, which affected overall OEM sales performance. Going forward, we expect STL to register healthy net sales CAGR of ~14% over FY2014-16E supported by healthy sales volume in the automobile industry owing to recovery in the Indian economy. Further, the company is also increasing its distribution network which would improve sales from the replacement markets. Hence, we expect STL's net sales to grow by ~13% yoy and ~15% yoy in FY2015 and FY2016, respectively.

Exhibit 10: Projected Net Sales growth trend



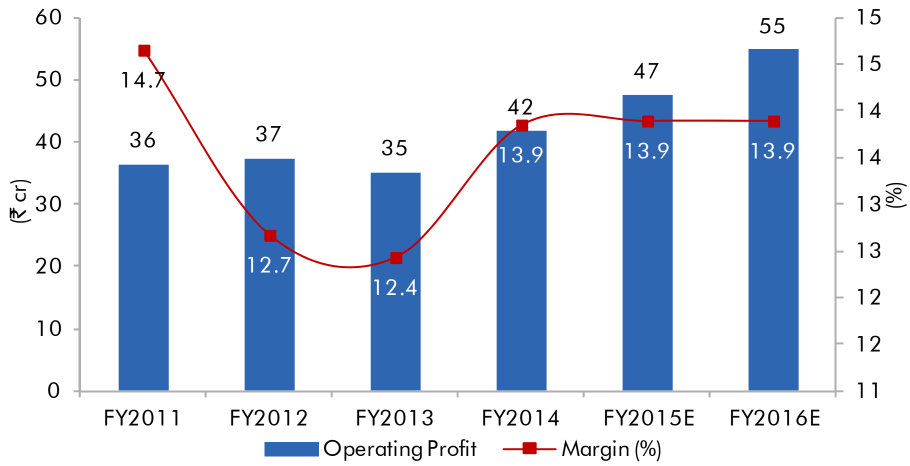
Source: Company, Angel Research

EBITDA to witness a CAGR of ~15% over FY2014-16E

Going forward, we expect the company's operating margin to be in the range of 13.5-13.9%

Going forward, we expect the company's operating margin to be in the range of 13.5-13.9% owing to cost effective management strategy, higher capacity utilization, and better product mix.

Exhibit 11: Projected Operating profit growth and margin trend



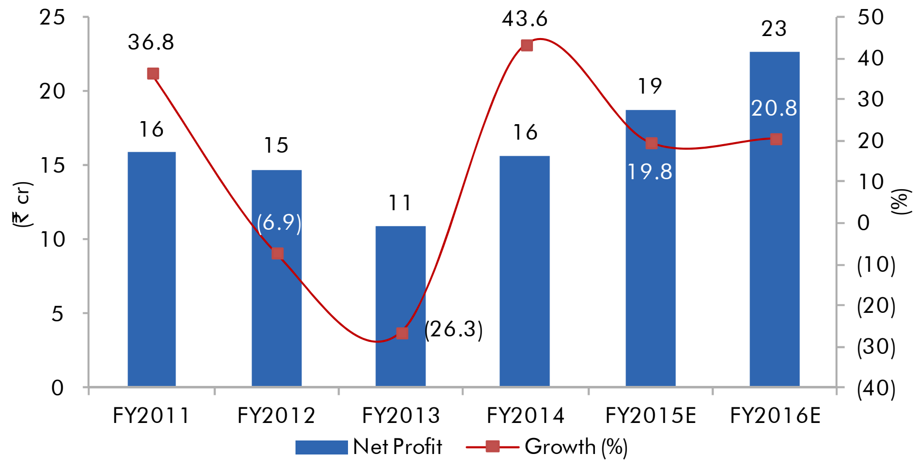
Source: Company, Angel Research

Company to report healthy Net Profit growth

We expect ~20% CAGR in Net Profit over FY2014-16E

We expect the company to post an ~20% CAGR in net profit over FY2014-16E, mainly led by strong revenue growth, better margin and lower interest cost.

Exhibit 12: Projected Net Profit growth trend



Source: Company, Angel Research

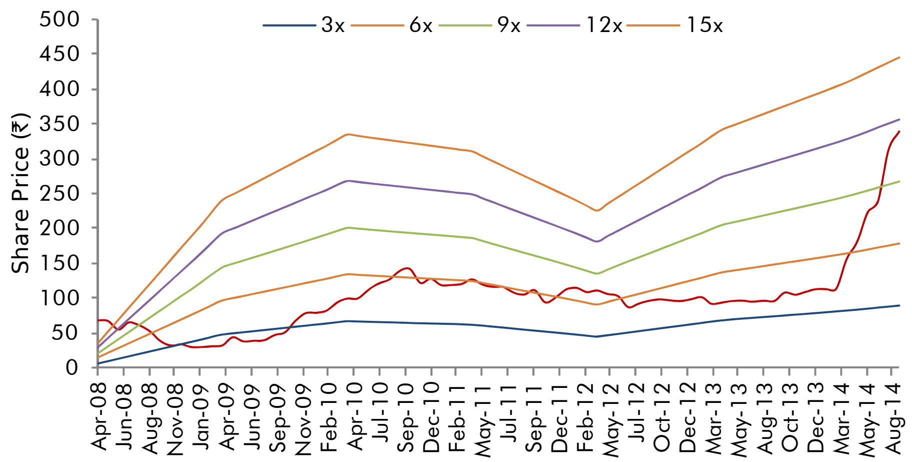
Outlook and Valuation

Going ahead, we expect STL to report net sales CAGR of ~14% over FY2014-16 to ~₹394cr owing to recovery in automobile sales volumes in both domestic as well as export markets. This will lead to recurring business opportunities for auto ancillary companies like STL. Going ahead, the company would improve its volume growth in the fasteners segment driven by healthy volume growth from OEMs customers like Honda Motorcycle & Scooters India, Maruti Suzuki India, Tata Motors, Ashok Leyland, Daimler, Fiat, Hero Motocorp, Mahindra & Mahindra, Volvo, Eicher, TAFE and General Motors.

On the profitability front, we forecast STL to report a net profit CAGR of ~20% over FY2014-16 to ~₹23cr owing to healthy sales and better operating margins due to better product mix and cost effective management strategy.

At the current market price of ₹332, the stock trades at a PE of 12.1x and 10.0x its FY2015E and FY2016E EPS of ₹27.4 and ₹33.1, respectively. We initiate coverage on the stock with a Buy recommendation and target price of ₹397, based on 12x FY2016E EPS, indicating an upside of ~20% from the current levels.

Exhibit 13: One-year forward P/E band



Source: Company, Angel Research

The downside risks to our estimates include 1) any increase in input costs (ie steel, iron, etc.) could negatively impact profitability, and 2) downturn in the automobile industry could affect business growth.

Company Background

Sterling Tools Limited (STL), founded in 1979, engages in manufacturing of high-tensile (HT) cold forged fasteners mainly for automobiles. The company is one of the top-3 fastener manufacturers in India and caters to leading automotive companies in India, Europe, South America and USA-NAFTA. Its product portfolio includes special fasteners, standard fasteners, surface treatment and coatings, chassis fasteners and engine fasteners. Its product range includes over 2,000 types of fasteners ranging from 5mm to 24mm in diameter. The company has three manufacturing plants in Haryana with a total capacity of 41,600 MT and has over 1,000 employees. STL is the largest supplier of HT fasteners to Honda Motorcycle & Scooters India and the second largest supplier to Maruti Suzuki India and Tata Motors. The company's other blue chip customers include Ashok Leyland, Daimler, Fiat, Hero Motocorp, Mahindra & Mahindra, Volvo, Eicher, TAFE and General Motors.

Exhibit 14: Product Profile

Special Fasteners	Standard Fasteners	Chassis Fasteners	Engine Fasteners
Designed specially for unique customer specifications, available in a variety of surface protection coatings	Include socket head cap screws, hexagonal head bolts, studs, hexagon nuts and weld nuts	Include hub/wheel bolts, hub nuts, wheel studs, bolts, rivets and two wheeler spindles/ wheel axles	Include cylinder head bolts/screws, fly wheel bolts, connecting rod bolts/nuts, balance weight bolts
			

Source: Company, Angel Research

Profit & Loss Statement

Y/E March (₹ cr)	FY2011	FY2012	FY2013	FY2014	FY2015E	FY2016E
Total operating income	248	295	283	301	342	394
% chg	*38.0*	*18.8*	*(4.2)*	*6.7*	*13.4*	*15.4*
Total Expenditure	212	258	247	260	294	339
Cost of Materials	113	135	130	131	150	175
Personnel	21	24	24	26	30	35
Others	78	99	93	103	114	129
EBITDA	36	37	35	42	47	55
% chg	*19.6*	*2.7*	*(6.0)*	*18.8*	*13.7*	*15.4*
(% of Net Sales)	*14.7*	*12.7*	*12.4*	*13.9*	*13.9*	*13.9*
Depreciation & Amortisation	6	8	9	10	11	12
EBIT	30	29	26	31	36	42
% chg	*24.2*	*(1.8)*	*(12.6)*	*22.3*	*15.2*	*16.8*
(% of Net Sales)	*12.1*	*10.0*	*9.1*	*10.4*	*10.6*	*10.7*
Interest & other Charges	7	10	10	8	8	8
Other Income	0	1	2	1	1	1
(% of PBT)	*1.4*	*3.0*	*9.2*	*3.6*	*3.4*	*2.8*
Share in profit of Associates	-	-	-	-	-	-
Recurring PBT	24	20	17	24	29	35
% chg	*26.9*	*(14.1)*	*(14.9)*	*39.9*	*20.8*	*20.8*
Prior Period & Extraordinary Exp./(Inc.)	-	-	-	-	-	-
PBT (reported)	24	20	17	24	29	35
Tax	8	6	6	9	11	13
(% of PBT)	*33.0*	*27.4*	*37.1*	*35.5*	*36.0*	*36.0*
PAT (reported)	16	15	11	16	19	23
ADJ. PAT	16	15	11	16	19	23
% chg	*36.8*	*(6.9)*	*(26.3)*	*43.6*	*19.8*	*20.8*
(% of Net Sales)	*6.4*	*5.0*	*3.9*	*5.2*	*5.5*	*5.7*
Basic EPS (₹)	23.2	21.6	15.9	22.8	27.4	33.1
Fully Diluted EPS (₹)	23.2	21.6	15.9	22.8	27.4	33.1
% chg	*36.8*	*(6.9)*	*(26.3)*	*43.6*	*19.8*	*20.8*

Balance Sheet

Y/E March (₹ cr)	FY2011	FY2012	FY2013	FY2014	FY2015E	FY2016E
SOURCES OF FUNDS						
Equity Share Capital	7	7	7	7	7	7
Reserves& Surplus	64	75	82	94	109	128
Shareholders Funds	**71**	**82**	**89**	**101**	**116**	**135**
Minority Interest	-	-	-	-	-	-
Total Loans	77	93	88	65	65	65
Deferred Tax Liability	10	10	13	13	13	13
Total Liabilities	**158**	**186**	**190**	**179**	**194**	**213**
APPLICATION OF FUNDS						
Gross Block	135	155	170	186	206	228
Less: Acc. Depreciation	47	54	64	74	85	98
Net Block	**87**	**101**	**107**	**112**	**121**	**131**
Capital Work-in-Progress	0	1	0	-	-	-
Investments	**2**	**4**	**4**	**5**	**6**	**7**
Current Assets	95	108	99	90	100	113
Inventories	37	47	40	36	37	41
Sundry Debtors	40	41	37	35	37	41
Cash	8	5	8	6	10	12
Loans & Advances	10	8	10	11	13	17
Other Assets	1	7	4	2	2	2
Current liabilities	27	29	21	28	32	37
Net Current Assets	**69**	**79**	**78**	**62**	**67**	**76**
Deferred Tax Asset	1	1	1	-	-	-
Mis. Exp. not written off	-	-	-	-	-	-
Total Assets	**158**	**186**	**190**	**179**	**194**	**213**

Cashflow Statement

Y/E March (₹ cr)	FY2011	FY2012	FY2013	FY2014	FY2015E	FY2016E
Profit before tax	24	20	17	24	29	35
Depreciation	6	8	9	10	11	12
Change in Working Capital	(18)	(12)	8	11	(2)	(7)
Interest / Dividend (Net)	6	9	10	7	8	8
Direct taxes paid	(7)	(7)	(4)	(7)	(11)	(13)
Others	(0)	(0)	0	2	0	0
Cash Flow from Operations	11	19	41	49	36	36
(Inc.)/ Dec. in Fixed Assets	(17)	(22)	(15)	(16)	(20)	(22)
(Inc.)/ Dec. in Investments	(2)	(2)	-	(1)	(1)	(1)
Cash Flow from Investing	(18)	(24)	(15)	(17)	(21)	(23)
Issue of Equity	0	0	0	0	0	0
Inc./(Dec.) in loans	30	17	(6)	(22)	(0)	0
Dividend Paid (Incl. Tax)	(2)	(4)	(8)	(4)	(3)	(3)
Interest / Dividend (Net)	(15)	(10)	(10)	(7)	(8)	(8)
Cash Flow from Financing	13	4	(23)	(33)	(12)	(11)
Inc./(Dec.) in Cash	6	(2)	3	(2)	3	2
Opening Cash balances	2	8	5	8	6	10
Closing Cash balances	8	5	8	6	10	12

Key Ratios

Y/E March	FY2011	FY2012	FY2013	FY2014	FY2015E	FY2016E
Valuation Ratio (x)						
P/E (on FDEPS)	14.3	15.4	20.8	14.5	12.1	10.0
P/CEPS	10.2	10.0	11.2	8.7	7.6	6.5
P/BV	3.2	2.8	2.5	2.3	2.0	1.7
Dividend yield (%)	1.5	1.5	1.5	1.5	1.5	1.5
EV/Sales	1.2	1.1	1.1	0.9	0.8	0.7
EV/EBITDA	8.1	8.3	8.6	6.7	5.8	5.0
EV / Total Assets	1.6	1.4	1.4	1.4	1.2	1.1
Per Share Data (₹)						
EPS (Basic)	23.2	21.6	15.9	22.8	27.4	33.1
EPS (fully diluted)	23.2	21.6	15.9	22.8	27.4	33.1
Cash EPS	32.6	33.2	29.7	37.9	43.8	51.2
DPS	5.0	5.0	5.0	5.0	5.0	5.0
Book Value	104.2	120.0	130.0	147.0	169.4	197.5
Returns (%)						
ROCE	20.3	17.7	15.4	19.5	20.6	21.8
Angel ROIC (Pre-tax)	21.7	18.6	16.5	20.9	22.5	24.0
ROE	22.2	18.0	12.2	15.5	16.2	16.7
Turnover ratios (x)						
Asset Turnover (Gross Block)	2.8	2.9	2.6	2.7	2.8	3.0
Inventory / Sales (days)	55	58	52	43	40	38
Receivables (days)	59	50	48	42	40	38
Payables (days)	29	24	20	25	28	30
WC cycle (ex-cash) (days)	85	84	80	61	52	46

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DISCLAIMER

Note: Please refer to the important `Stock Holding Disclosure' report on the Angel website (Research Section). Also, please refer to the latest update on respective stocks for the disclosure status in respect of those stocks. Angel Broking Pvt. Limited and its affiliates may have investment positions in the stocks recommended in this report.

Disclosure of Interest Statement	**Sterling Tools**
1. Analyst ownership of the stock	No
2. Angel and its Group companies ownership of the stock	No
3. Angel and its Group companies' Directors ownership of the stock	No
4. Broking relationship with company covered	No

Note: We have not considered any Exposure below ₹ 1 lakh for Angel, its Group companies and Directors

Ratings (Returns):	*Buy (> 15%)*	*Accumulate (5% to 15%)*	*Neutral (-5 to 5%)*
	Reduce (-5% to -15%)	*Sell (< -15%)*	

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