"Sundram Fasteners Limited

Q2 FY27 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day, and welcome to the Sundram Fasteners Limited Q2 FY27 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing star then zero on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Krupashankar from Avendus. Thank you, and over to you.

Krupashankar: Good afternoon, everyone. I appreciate everybody logging in for the conference call of Sundram Fasteners. From the management team, I'm pleased to host Mr. R. Dilip Kumar, Chief Financial Officer; Mr. R. Ganesh, Vice President, Finance and Projects; and Mr. S. Bharathan, Executive Vice President, Marketing.

I now hand over the call to Mr. R. Dilip Kumar for his opening remarks, after which we'll begin the Q&A session. Over to you, sir.

Dilip Kumar: Yes. Good afternoon to all the participants in the call. Welcome to the H1 analyst call, and we are happy to inform you that the company has recorded a strong performance, about 30% growth in revenues for Q2. And it's been driven by the OE segment, as most of you may have known or heard about it. The pull has been strong, and the traction has been good.

And we've also had a stellar performance in the export segment, where compared to the corresponding quarter, we have recorded a 57% growth in exports. And of course, to some extent, about 10% is helped by dollar-rupee, and because of rupee weakness, the balance of 47% has come in the volume terms and dollar terms, where our key customers like Cummins and Navistar had recorded very good revenues and their schedules have improved.

The raw material cost, as most of you may have known, had increased in Q1, the steel and aluminum prices. And it has continued in Q2 as well. And also on the indirect

materials like stores and tools, which is a big line item for auto component companies because of the war. We have experienced inflation there also.

As Sundram Fasteners generally recovers the RM inflation from the customer, we have pass-through arrangements, especially in the domestic market. But we have raised the prices in the aftermarket prospectively. Also, in the export market, it is offset by rupee depreciation.

And also when the raw material prices fall, we are not under an obligation to pass back to our customers. But having said all this, the steep increase in RM prices have had an impact, notwithstanding the recovery as they had an impact at the contribution level compared to the corresponding quarter, almost 3%.

But we have been able to offset that to some extent by operating leverage. Our fixed costs have been lower. And also the asset utilization, since it has improved substantially, the depreciation charge, not in terms of absolute amount, but in relation to revenues, have been lower.

And we had reported a PBT of INR160 crores compared to INR140 crores for the quarter. Likewise, for the half year, INR3,254 crores of revenues compared to INR2,605 crores, 25% growth, again, a strong performance of 40% in exports, and the OE business has done well.

And as I explained for the quarter, the inflationary pressures in Q1 and Q2 on both indirect materials and direct materials have had an effect in our contribution. And likewise, the fixed costs have been lower by almost 1% and the depreciation, again, has been lower compared to the previous corresponding quarter.

And the EBITDA for the half year is just a notch below 16%, 15.9%. And for Q2, it's been 15.7%. But I want to assure you that the markets, the customer schedules are strong, which my colleague, Bharathan, will explain later. And we are quite excited about the outlook for exports.

And as our exports, in fact, had dropped due to tariff and other impact last year to around 25% of our total revenues, it's back to almost 30% now. And these are high-margin products which are in excess of 20% EBITDA.

So as more exports come into our book and go back to our one-third, which used to be the case about 2 years back, you will see that the margin expansion takes place automatically. The steel prices, which went very high post-COVID or during COVID and then was rolled back, and likewise, now it started inching up. So once the pricing cools off, we will benefit from that also.

So basically, the margin drop is more, I would say, a mathematical expression of the RM prices, which are there in the middle line, and the revenues, which are slightly inflated. If you remove that impact and see the margins, of course, we have the information internally, and it is clearly about 1.5% higher than what has been reported as EBITDA. So anyway, the half-yearly performance, we have reported INR311 crores compared to INR278 crores. And the outlook continues to remain strong.

With this, I will close my opening remarks. We are happy to take questions. Thank you.

Moderator: Thank you. We will now begin the question-and-answer session. The first question is from the line of Lakshminarayanan KG from Tunga Investments.

Lakshminarayanan KG: Just one question. So we see that some of the OEs have reported drastic -- Indian OEs have reported almost 500 basis points to 400 basis points decline in gross margins due to material cost. So how does it pass on, whether that impact on us will come retrospectively or, when you go for a pricing increase, do you take it from April 1 or do you actually have it prospectively?

And this particular thing of 400, 500 basis points decline in gross margin, when it will kind of flow into our thing, whether it will happen next quarter or so? And what time it will become a steady state? Because you mentioned that we have a mechanism where almost all the material costs will have a catch-up, and it will be passed through, right? I just want to understand how to think about it.

Second question is that if you look at the cash flows from operations, there has been a little underwhelming. Is it because of the export being high? Or can you just elaborate? If you break it down between exports and domestic, where did you see this particular strain in the cash flows?

And the last thing I want to understand from the domestic market OE, what is the business mix? And which segment is actually propelling growth and which segment you think will actually would be underwhelming for the upcoming financial year?

Dilip Kumar: Yes. On the cash flows, which is your second question, the cash flows are not stressed. Yes, compared to the previous period when the exports were much lower, the cycle was much shorter. Typically, exports have a very long cycle, can stretch up to 9 months. So the inventories have gone up in line with our activity. The receivables have gone up in line with our activity. And there have also been some piling up of input credit because of the procurement of raw materials at inflated prices and the capital expenditure program of the company.

Typically, we have a lot of subcontracting operations. And therefore, as the material moves out and comes back, there is a quite amount of GST input credit, which is piled up in our books. So these are some of the reasons why it appears as stressed, but I just want to assure you that we have sufficient banking limits, and we think, going forward, that the borrowings will moderate and the cash flows will improve and come back to normal levels. That is on question number two.

On question number one, it is an ongoing exercise where pass-through happens most often immediately, which varies from customer to customer. But in general, we recover the OE segment immediately. And in some cases, depending on the customer, it used to operate with a lag effect of 3 months.

And even that has been corrected now, I think this indexation happens with a 1-month lag. And it is not that these are lost, because when the prices get corrected, because it happens with a 3-month lag, you continue to get the benefit of higher prices from

the OEM for aluminum and then it gets reset only 3 months later. So it works both ways.

And while we have got in the OE segment, most of the price increases that we have given to the steel mills, but the 40% of our business is, 10% is aftermarket and about 30% is export, where we have felt the benefit of -- I mean where we have had the impact of brunt of this RM price increase, but corresponding compensation is not there. And depending on the competitive intensity, we have also raised prices in the aftermarket. So I must tell you that...

R. Ganesh: So I think with respect to this raw material, it's accounted based on whenever the price settlement happens. So it's not prospective. As and when the agreement is reached between the OEM and steel mill, the steel mills also confirms it to us and then they raise the invoices for the increment RM value.

Lakshminarayanan KG: Okay. No, I'm just -- because the last quarter, you would have got some benefit of the FIFO inventory, right? Therefore, I was just thinking the drop in the gross margin for OEs have been very significant. So whether this will actually occur in Q3? Or is it already we have got the major brunt of it?

Dilip Kumar: It is already there in our P&L.

Lakshminarayanan KG: Okay. Fair enough. So you don't see prospectively, it will not worsen?

Dilip Kumar: No, it will not. It will not worsen. If at all, like I said, some specific customers, there could be a 1-month lag effect. We will only get the benefit of that in Q3. But the brunt is already there in our P&L, unless the RM prices are further revised upwards.

R. Ganesh: And to answer your third question with respect to the domestic, I think the propelling is happening on the car segment and M&HCV as well. And whatever we have invested as part of our wind energy growth, that is also helping. So it's, I would say, growth on all segments.

Lakshminarayanan KG: Got it. Got it, sir. Sir, one last thing. If you start of the quarter and also end of the last financial year, you mentioned that you see good buoyancy in your order book and things are getting much better. So when we started this quarter and we have been Q1

to Q2 and where we stand now, how things are looking at? Is it looking better than what it was in the start of the year? Or how is it?

R. Ganesh: Bharathan? Hello, Bharathan?

Moderator: Hello, Mr. Bharathan?

R. Ganesh: No, I would answer. See, for us, the OEMs, in general, give a 1-month firm schedule and 2 months indicative for preparing or planning our activities. So that way, the buoyancy still continues. And irrespective of the segment in the domestic or in exports, continued schedules are available. So that way, I think the sustenance of the turnover at this level, we do not see any -- it's only prospective growth that we are seeing.

Moderator: The next question comes from the line of Krupashankar from Avendus.

Krupashankar: Sir, 3 questions from my side. Just wanted to get a sense of the outlook on the EV business in U.S., if you can share something on that? And any sense of timelines of the INR4,000 crores order book, which we have, as to when it will be recorded in revenues? And anything else which you can share with respect to any incremental orders, sir?

R. Ganesh: See, I think with respect to the EV orders, while it's still in the lull phase, but as part of the overall contract, whatever we have got in terms of plug-in hybrid and the ICE portion. I think there, we have started billing with the customer. So since this business is towards Stellantis, which was last year about INR50 crores or so, I think this year, we are looking at between INR150 crores to INR175 crores. So that way, we are seeing momentum in it.

And I think with respect to reaching the peak volume, I think it would be by the second half of next year, we should be able to have a clearer picture. But as of now, with respect to the contract, whatever is related to plug-in hybrid and ICE, I think the billing or activity is happening. That is a positive sign. And we are also working with other customers in terms of propelling this whatever investment that we have made.

Krupashankar: Understood, sir. Understood. The second part on the exports, specifically on the Class 8 demand beyond CY26, considering the pre-buy scenario coming in. Any conversations

you've had with your customers and how they are looking at overall demand shaping up? Any thoughts around that, sir?

Dilip Kumar: Sir, just hold on for some time. We'll get our Bharathan back on the line. He's the Marketing Chief. He'll be in a better position to answer that.

Krupashankar: Sure.

Dilip Kumar: We'll just mark that.

Moderator: Mr. Bharathan's line was disconnected. I'm trying to reconnect him. Just give me a moment. In the meantime, if you want to answer the question, you can, or I can turn on the music.

Dilip Kumar: Yes. So I've clarified saying that we will answer -- take that question later after -- the question which are relating to marketing, we'll take it a bit later.

Krupashankar: If I may, meanwhile, can I ask on the non-auto segment side of things, right? Would that be -- can I go ahead with that question?

Dilip Kumar: Okay. Can you repeat the question, please? Sorry.

Krupashankar: So I just wanted to check if, in meanwhile, while Mr. Bharathan's line gets connected, can I ask a question on the non-auto side?

Dilip Kumar: Yes, yes, please.

Krupashankar: Yes. So just wanted to get a sense around the traction and the targets in the non-auto segment, especially on wind, aerospace, railways? And what would be the quantum of investments we are planning over here?

R. Ganesh: See, I think with respect to the investments in wind energy, I think the third phase of investment is ongoing. So that should see us cross about INR500 crores of annual revenue with respect to wind energy. I think the investment, whatever we have indicated, was close to about INR70 crores to INR80 crores.

So that is getting executed, and that is on the wind energy side. With respect to aerospace, I think last year, whatever we have clocked at INR50 crores, and this year, we are looking at INR100 crores plus. There, again, we have looked at investments for taking it to the next level of INR200 crores in the coming years.

So there, we have looked at investment of about INR30 crores to INR40 crores in various testing and other equipment. So that is on the aerospace. With respect to railways, I think for the tenders and orders which we are winning, we have been able to service with the existing capacity. So we have not looked at separate investment further.

But on the whole, with respect to non-auto as a segment, while the aspiration is to look at 50%, but I think we have been moving steadily from the earlier years of 30% and this year, we have come to 35% plus.

So there is a positive traction on the non-auto side. Added to further on wind and aero is we also service the host of fastener requirement on varied industrial applications to our aftermarket. I think that is also propelling us in terms of our non-auto growth.

Krupashankar: Got it, sir. So Bharathan, there was one question on the exports business, especially on the Class 8 demand. Beyond the CY26 pre-buy, right, how do you expect the demand to improve? And have you had any conversations with your customers on this space?

S. Bharathan: Yes. See, as far as the Class 8 demand is concerned, during the beginning of the year, due to the lack of clarity on the EPA '27 norms, there was a lot of confusion. But overall, a lot of clarity has emerged now, though on the pricing front, there is still some gray area.

But as far as the EPA '27 norms are concerned, I think there has been a certain deferment of the decision as far as the life of the heavy duty engine is concerned, I think it has been postponed by 3 years. And on the emission parts warranty also, they are continuing with the current level of 5 years and 100,000 miles level.

And it's only on the NOx reduction from 200 milligrams per brake horsepower to 35 milligrams, they are enforcing. And I think almost all the OEMs have clarity on this as well as there's a clause on a non-compliance penalty.

So it's a decision that every OEM can take and the buyer can take as to whether to opt for this non-compliance penalty or to go for a compliant vehicle. So to this extent, there

is clarity. And what indications are there is the backlog in terms of the Class 8 demand is much beyond the historic level.

In fact, in the past 12 months, the cumulative preliminary orders have summed up to 353,000 numbers. And so the order book is full for the OEM. And while on the retail front, there has been a 5% drop compared to the last year, year-to-date September. The hope is that by the end of the year, it will be plus by around 3% to 5% compared to last year.

The initial projection of 232,000 trucks for Class 8, while some are holding on to it, some say it will be between around 210,000 to 220,000. So this is on the Class 8 trucks, sir. So the on-road demand overall is good. That's the message from our customers as well.

Moderator: The next question comes from the line of Gaurav Ashok Bhanshali from Augmont Enterprises.

Gaurav Ashok Bhanshali: Congratulations on a good set of numbers. Sir, I wanted to ask, our other expenses have gone up by 32% year-on-year. So what has led to that?

Dilip Kumar: The other expenses are in line with the operations. If you see 25% growth for H1 and 33% growth for the quarter, it only reflects the operations.

Gaurav Ashok Bhanshali: Okay, sir. And earlier, we outlined a capex outlay of INR400 crores for current FY, and we've already done INR280 crores -- INR281 crores. So is there an increase in capex outlay for FY27 from the earlier communicated number? And what would be the capex outlay look like for FY28?

Dilip Kumar: FY27, we are on course to complete the program, and we don't see -- if at all, it may be only slightly on the higher side, depending on customer requirements. And as far as FY28, slightly premature. And as you would have seen in the past, we have been incurring around INR350 crores to INR450 crores is a broad range.

So at that level, it should continue, but I'll be able to give you a better answer after our Q3 because by then, the business plan for the company would have taken shape. And as of now, you can take these as indicative numbers.

Gaurav Ashok Bhanshali: Okay, sir. And on a consolidated level, we grew by 25 percentage versus H1 FY26. So H2 will echo the same growth? What should we expect? Not asking for any guidance, but rough estimate.

R. Ganesh: So given the current market indications, I think H2 would also mirror a similar growth.

Gaurav Ashok Bhanshali: Okay, sir. And any guidance on FY28?

R. Ganesh: It's premature given the volatile situation.

Moderator: Next question comes from the line of Himanshu Singh from Baroda BNP Paribas Mutual Fund.

Himanshu Singh: Congratulations on a good set of numbers. Sir, just last quarter, you indicated the tonnage volume growth was around 13%. Can you just give the number for this quarter?

R. Ganesh: I think the current quarter mirrors 15% to 16% in terms of tonnage.

Himanshu Singh: Okay. Okay. And sir, last quarter, you had highlighted that the run rate of 20% growth should continue for the full year. Now we have grown by almost 32% on the standalone basis, consolidated basis also around more than 30%. So how should we see this growth going ahead, let's say, for the full year?

Dilip Kumar: I think -- sorry, Bharathan, go ahead. Go ahead.

S. Bharathan: No, see, I just want to assure that the growth for the overall year compared to H1 will also be almost at the same level. On all the segments, our business segments of OE, retail as well as exports, we are seeing a slight improvement over the H1.

Himanshu Singh: Okay. Okay. And just on the margin side, margins have fallen. You also explained it that it's arithmetic. But do you see the 150 basis points coming back in the second half?

Dilip Kumar: Yes, the margin should definitely expand, and that optimism is primarily from the higher share of exports in our revenue book. So the margin should expand.

Himanshu Singh: Okay. And sir, the non-auto business for this quarter was how much?

R. Ganesh: The non-auto as a percentage to overall hovers between 35% to 37%.

Moderator: The next question comes from the line of Sahil Sanghvi from Monarch Networth Capital.

Sahil Sanghvi: A huge set of congratulations for giving a good set of numbers. Sir, so my first question is, can you give me some details on how the subsidiaries have performed, especially China and the other one overseas?

R. Ganesh: No, I think with respect to China, while it had grown in terms of the local currency at 10% to 12%, in terms of Indian rupee, the overall growth is 25% to 30% level. And the activity with respect to China subsidiary has continued to do well on the backdrop of our presence or participation with the construction equipment segment and our supplies to CVs. So we see strong numbers going forward with respect to China subsidiary.

On the other subsidiary in U.K., it mirrors the truck market growth in Europe because our supplies are to European customers. And there, again, in rupee terms, we have posted a 20% plus growth despite the uncertainties in the market. I think both the subsidiaries have done reasonably well.

Sahil Sanghvi: And sir, on the profitability, have we seen improvement for these subsidiaries?

R. Ganesh: Yes. Both the subsidiaries are profitable and continue to post robust numbers.

Sahil Sanghvi: Okay. Okay. Understood. Understood. Now just for the domestic demand that we foresee for the second half, I mean, the momentum continues to be the same as first half because, I mean, we move to a higher base, which is more of an optical phenomenon. But with respect to ground level activity, how do you see that?

S. Bharathan: See, as far as the domestic demand is concerned, except for the tractor segment, where we see some softening of demand is going to happen, especially in Q3, that is this quarter, which we are in, and maybe a slightly moderate demand in Q4 due to the base effect as well as the uneven monsoon that is predicted.

I think the IMD prediction is somewhere between 88% to 112% of the normal average level, so there is some concern on the demand side on the tractor segment. And it is only this segment where we see, in absolute terms, maybe there might be a fall in numbers compared to H1. However, overall for the year, I think this will also be plus compared to last year, even the tractor segment.

And coming to the other segment, say, the medium and heavy commercial and the light commercial, the first half has been exceedingly well -- they've done exceedingly well. The medium and heavy commercial clocked in 21% growth and the LCV at 27%. So both together in the commercial vehicle segment at a 25% growth in H1.

While we don't see -- because of the high base effect, we don't see a similar growth percentage. The activity levels are not going to be down. The numbers will be slightly higher than the first half.

And even in the car and SUV segment, due to the small setback that might be seen in the rural segment because of the uneven monsoon, again and the cash flows getting affected due to the agricultural outputs, while the entry level car and the sedans might face some pressure, we feel that the second half should be slightly -- would be slightly down in terms of percentage. But in terms of numbers, it will still be higher than the first half.

So overall, while the growth percentages will moderate, maybe to low double digits for cars and SUV and the mid-teens for the commercial vehicles, tractors will be around less than 10%, maybe 6%, 7%, with a bias towards 5%, say 6%, 7%. Overall, there will be a growth. And we see in all somewhere around 3% to 5% up in the domestic performance as well in H2.

Sahil Sanghvi: Sure, sir. This is very detailed understanding. Lastly, on the new product development or from the perspective of new customer additions, is there anything incremental to add? I mean, over and above what we have already discussed on the wind side, the aerospace side or the non-auto side, anything incremental to add?

R. Ganesh: I think we have covered whatever is the incremental or new businesses, which we have been working on. I think nothing more to cover.

Moderator: The next question comes from the line of Lakshminarayanan KG from Tunga Investments.

Lakshminarayanan KG: Sir, I think somewhere on the call, you mentioned that there are material cost increases and there are also indirect cost increases like gas, etc. Can you just quantify as to what

percentage of increase you found that is there in the gas and other fuel cost, which actually has, actually, materially stepped up, I guess, in the first half? And what that impacted your margins? That is one question?

The second question is that has there been any foreign exchange gain or loss for the first half? And the third, in terms of new product development, is there a metric you actually track? And in that metric, how we have performed, either new products or new clients? If you can just give some quantifiable numbers on new product development? These are my 3 questions?

R. Ganesh: Yes. I think on the new product, I think we have a benchmark of whatever parts that we have developed in a particular year and over a period of the development plus the next 3 years, it should generate a 20% revenue. That is the internal guideline that we use. And as against that, I think we are fairly performing to the target.

So that is one of the reasons where you see an uptick in terms of revenue basis the new products that have been developed over the years. So it's as per plan. That is how I would put it. On IDM and forex gain, our CFO would respond.

Dilip Kumar: On foreign exchange, rupee realization, since the rupee has been in a narrow range this quarter, well, we have certainly benefited. As you know, from the accounting standard perspective, we accrue the revenues based on the exchange rates prevailing on the date of raising the invoice, and subsequently, the exchange difference are adjusted. So it is about INR7 crores of exchange gain we have recorded for the quarter.

Lakshminarayanan KG: For the first half, sir?

Dilip Kumar: No, no. This is for the quarter.

Lakshminarayanan KG: For the quarter, okay.

Dilip Kumar: Yes, yes. And on the raw material prices, what has happened is that the impact of price revision, which we have given is about 3.7% of the revenues. And the realization from customers have been around 2.5% roughly. So we have about 1% gap. But mathematically, if you add these 2 in respect to line items, it has caused a dip in the contribution or the gross margin around 2.5%.

Lakshminarayanan KG: Got it. And we also see a significant increase in gas-related cost? Because there's a lot of sintering which you do, and that would require a substantial amount of gas. So what has been the increase? And can you just quantify that, sir?

R. Ganesh: See, with respect to gas, prior to this geopolitical, I think it was sub INR100 with respect to either HSD or other petroleum-related products. And I think it went to a peak of about INR200 plus. And now it has moderated around INR150. So that way, we have seen more than 100% increase in some of the items. But now it has come down, but still not yet to the pre-March '26 level.

Lakshminarayanan KG: I mean my question is, how much -- if you quantify it, right, because this entire cost increase or the EBITDA margin drop, how much would be on account of this increase, which may look like a one-off thing?

Dilip Kumar: So that will be negligible, sir. The overall scheme of things, it is the raw material prices which cause an impact. And the indirect materials, well, they are not significant, but it is not going to materially alter the margin.

Moderator: Thank you. Ladies and gentlemen, as there are no further questions, we have reached the end of question-and-answer session. I now hand the conference over to management for closing comments. Thank you, and over to you.

Dilip Kumar: Yes, nothing specific to add. We have answered the questions as it is. And the outlook looks promising. I want to conclude on an optimistic note.

R. Ganesh: Thank you, sir.

Moderator: Thank you. On behalf of Avendus, that concludes this conference. Thank you for joining us, and you may now disconnect your lines.