

January 19, 2008

Rating	Outperformer
Price	Rs64
Target Price	Rs82
Implied Upside	28%
Sensex	19,014

(Prices as on January 18, 2008)

Trading Data

Market Cap. (Rs bn)	5.9
Shares o/s (m)	92.3
Free Float	58.8%
Avg. Daily Vol ('000)	116.3
Avg. Daily Value (Rs m)	6.7

Major Shareholders

Promoters	51.5%
Foreign	0.3%
Domestic Inst.	13.5%
Public & Others	34.7%

Stock Performance

(%)	1M	6M	12M
Absolute	(0.1)	12.5	0.9
Relative	0.3	(11.8)	(32.9)

Price Performance (RIC: SONA.BO, BB: SONA IN)



Source: Bloomberg

Sona Koyo Steering Systems

Firm rupee hurts exports, growth

- **Results:** Sona Koyo Steering Systems (SKSSL) reported 14.6% rise in revenue to Rs1,720m in Q3FY08 over a high base quarter last year, we expected 26% growth to Rs1,892m. Operating margin at 10.8% was better by 84bps YoY and just 18bps lower sequentially. Topline growth and better margins resulted in 10.4% YoY growth in PAT to Rs73m.
- **Capex update:** SKSSL has completed its second line of CEPS at Daruhera (capacity increased from 1.75lakh units to 3.5lakh units) and also completed the expansion of its Chennai unit. The company intends to incur a capex of Rs1.4bn in FY08E and another Rs2bn over the next 18 months.
- **Valuation:** The passenger car segment has exhibited 13.2% growth in FY08 evading the declining automobile sales trend. With global auto majors like Volkswagen, Toyota Motor Corp, Honda Motor and Fiat planning to launch low cost cars from India, the segment is expected to see robust growth for the next 2-3years. With the company's capex plans on track, SKSSL is in a position to leverage the current boom in the industry.

At the ruling market price of Rs64, the stock trades at 13.1x FY09E EPS of Rs4.9 and at 9.3x FY10E EPS of Rs6.9. Considering the attractive growth prospects for the company, we maintain Outperformer rating on the stock.

Key financials (Rs m)	FY07	FY08E	FY09E	FY10E
Revenue	5,804	6,870	8,952	11,215
Growth (%)	70.9	18.4	30.3	25.3
EBITDA	618	761	1,032	1,349
PAT	277	365	502	701
EPS (Rs)	3.0	3.6	4.9	6.9
Growth (%)	70.5	18.8	37.5	39.8
Net DPS (Rs)	0.7	2.0	2.0	2.0

Source: Company Data; PL Research

Profitability & valuation	FY07	FY08E	FY09E	FY10E
EBITDA margin (%)	10.6	11.1	11.5	12.0
RoE (%)	25.5	20.6	21.5	25.9
RoCE (%)	16.2	13.1	12.3	14.4
EV / sales (x)	1.2	1.2	1.0	0.8
EV / EBITDA (x)	11.1	11.2	9.0	6.9
PE (x)	21.3	18.0	13.1	9.3
P / BV (x)	4.4	3.0	2.7	2.2
Net dividend yield (%)	1.1	3.1	3.1	3.1

Source: Company Data; PL Research

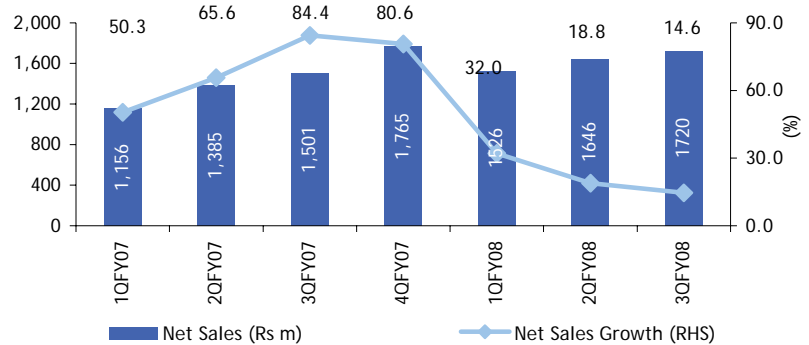
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Highlights

Revenue growth subdued

SKSSL reported 14.6% rise in revenue to Rs1,720m in Q3FY08 as against our expectation of Rs1,892m. Growth during the quarter was muted mainly due to the company's decision of slowing down US exports. Domestic topline growth was driven by 17% volume growth registered by its top customer, Maruti Suzuki, which contributes 52% of its total revenue.

Slower growth over high base



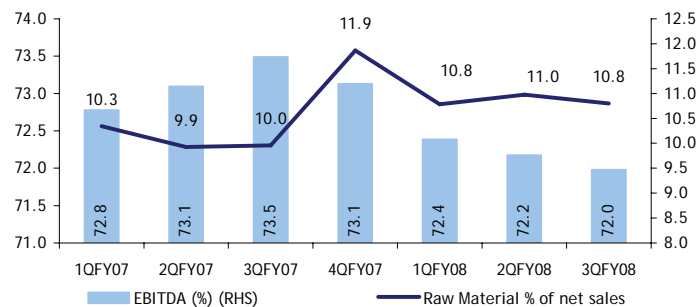
Source: Company Data, PL Research

Revenue growth has been subdued for the company over an already higher base year.

Higher localisation content leads to margin improvement

Operating margin at 10.8% was better by 84bps YoY and just 18bps lower sequentially. Increased localisation content helped reduce raw material cost. However, margin expansion was limited by higher staff cost. Employee expense was substantially higher due to salary hikes for all its employees during the quarter.

Higher staff cost limits margin expansion



Source: Company Data, PL Research

PAT growth up 10.4% YoY

Net interest cost was higher during the quarter, as the company recorded lower foreign currency translation gain of Rs3.1m during the quarter (Rs15.5m in Q2FY08). The company also reported higher depreciation as its capacity expansion at Daruhera and Chennai were completed during the quarter. As a result, despite 14.6% topline growth and better margins, PAT grew only by 10.4% to Rs73m.

Conference call highlights

The company would be one of the suppliers to Tata's *Nano*, for which it has been awarded 50% of the steering systems business (1.25lakh units) and 100% differential assembly unit (2.5lakh units). While in phase I, the company expects Rs200m revenue from the small car, it expects to double its revenue in the second phase.

SKSSL has completed its second line of CEPS at Daruhera (capacity increased from 1.75lakh units to 3.5lakh units) and also completed the expansion of its Chennai unit. The company intends to incur a capex of Rs1.4bn in FY08E and another Rs2bn over the next 18 months.

It has received orders from Tata Fiat (Rs300m p.a.) and Tata Motors (Rs100m p.a.) during the quarter. The Rs100m order from Tata Motors is for Tata's *Ace*, for which components would be supplied from the company's new facility at Uttarakhand.

Estimates revised, FY10 estimates introduced

We have revised our topline estimates downwards by 7.6% and 14.7% for FY08 and FY09 respectively due to lower than anticipated topline growth. Part of the capex worth Rs600m would go to the four JVs, thereby limiting growth in the company. Hence, we revise our PAT estimates downwards by 6.4% and 10.7% for FY08E and FY09E respectively.

Estimates revised

	Revised estimates		Earlier estimates		% revision	
	FY08E	FY09E	FY08E	FY09E	FY08E	FY09E
Net sales (Rs m)	6,870	8,952	7,434	10,500	(7.6)	(14.7)
Adj. PAT (Rs m)	365	502	390	562	(6.4)	(10.7)
EPS (Rs)	3.6	4.9	3.8	5.5	(6.4)	(10.7)

We are introducing estimates for FY10. The management has guided for revenue of Rs200m from *Nano* in the first phase. The company has also



secured additional orders worth Rs400m during the quarter. With its capex plans on schedule, and a slew of launches planned by global majors in India, SKSSL is expected to bag a number of such orders. Hence, we expect the company's topline to grow 25% to Rs11.2bn in FY10 over an already higher base year. With margins slated to improve, we expect PAT to grow by 40% to Rs701m in FY10.

Valuation

The passenger car segment has exhibited 13.2% growth in FY08 evading the declining automobile sales trend. This growth is expected to continue going forward with as many as 60 cars slated for launch in CY08. Also, with global auto majors like Volkswagen, Toyota Motor Corp, Honda Motor and Fiat planning to launch low cost cars from India, the segment is expected to see robust growth for the next 2-3years. To take advantage of this boom, the company has planned a capex plan of Rs4bn over four years, of which it has already completed a capex of Rs2bn till date. With the company's capex plans on track, SKSSL is in a position to leverage the current boom in the industry.

At the ruling market price of Rs64, the stock trades at 13.1x FY09E EPS of Rs4.9 and at 9.3x FY10E EPS of Rs6.9. Considering the attractive growth prospects for SKSSL, we maintain Outperformer rating on the stock.



Q3 FY08 result overview

(Rs m)

Y/e March	Q3FY08	Q3FY07	YoY gr. (%)	Q2FY08	9MFY08	9MFY07	YoY gr. (%)
Net sales	1,720	1,501	14.6	1,646	4,892	4,042	21.0
Expenditure							
Raw material	1,238	1,103	12.2	1,188	3,531	2,957	19.4
<i>as % of net sales</i>	72.0	73.5		72.2	72.2	73.2	
Personnel cost	134	103	29.7	115	360	276	30.5
<i>as % of net sales</i>	7.8	6.9		7.0	7.4	6.8	
Mfg. expenses	163	145	11.8	163	471	403	16.8
<i>as % of net sales</i>	9.4	9.7		9.9	9.6	10.0	
Total expenditure	1,535	1,352	13.5	1,465	4,361	3,636	20.0
EBITDA	186	150	24.3	181	531	407	30.6
<i>EBITDA margin (%)</i>	10.8	10.0	84.1	11.0	10.9	10.1	
Depreciation	48	32	50.8	40	127	102	24.9
EBIT	137	117	17.0	141	404	305	32.5
Net interest	29	21	40.0	12	50	72	(30.6)
Non-operating income	7	9	(19.8)	7	20	21	(4.7)
PBT	115	105	9.4	136	374	254	47.4
Total tax	42	39	7.8	48	133	87	52.9
<i>Total tax rate %</i>	36.3	36.9		35.2	35.6	34.3	
Adj. profit after tax	73	66	10.4	88	241	167	44.5



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PL's Recommendation Nomenclature

Buy	: > 15% Outperformance to BSE Sensex	Outperformer (OP)	: 5 to 15% Outperformance to Sensex
Market Performer (MP)	: -5 to 5% of Sensex Movement	Underperformer (UP)	: -5 to -15% of Underperformance to Sensex
Sell	: <-15% Relative to Sensex		
Not Rated (NR)	: No specific call on the stock	Under Review (UR)	: Rating likely to change shortly

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