

SONA KOYO STEERING SYSTEMS

INR 45

Burnt but not scarred!

BUY



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Sona Koyo Steering Systems (Sona) declared disappointing Q4FY08 numbers, with revenues growing a muted 10% Y-o-Y to INR 1.94 bn. EBITDA declined 52.5% Y-o-Y to INR 103 mn, with EBITDA margins reaching their 22-quarter low of 5.1%. This was on account of the combined impact of higher steel and other domestic raw material prices, along with rupee appreciation against the Yen, which inflated the import bill for column type electronic power steering (CEPS) components. Profit for the quarter stood at INR 11 mn, down ~90% Y-o-Y.

The unforeseen raw material price increase, and adverse currency fluctuations, could not be passed on to OEMs during the quarter. The management is confident of getting the bulk of the increase in prices, with retrospective impact, in the coming quarter.

The ongoing capex to localize CEPS is also onstream as planned, with no delays. The company is likely to start trial runs of its greenfield facility at Singur in Q1FY09E, with serial production likely to commence from H2FY09E. Sona is supplying the Tata *Nano* from this facility and is likely to get margins in the same range as their current line of products.

* Outlook and Valuations:

Damp topline growth is a cause of concern in the near-term, as the company still relies heavily on volume growth from its key customer, Maruti Suzuki. The loss of market share of Hyundai *Santro* to the *i10* has had a further adverse impact on the product mix, as margins on the hydraulic steering systems (for the *Santro*) are amongst the highest for Sona. Also, given the current volatility in input prices, margins could get suppressed by 50-100bps over FY09E-10E, depending on the extent of the price hike to OEMs. We have taken these concerns under consideration, and revised our PAT estimates downwards by 20.9% and 15.7% for FY09E and FY10E, respectively. The bulk of this correction is stemming from margin compression that could occur should input prices continue their rapid uptrend.

At CMP of INR 45, the stock is trading at a P/E 12.7x and 8.9x our revised EPS estimates of INR 3.5 and INR 5 for FY09E and FY10E, respectively. We maintain our 'BUY' recommendation.

Reuters : SONA.BO
Bloomberg : SONA IN

Market Data

52-week range (INR) : 74 / 36
Share in issue (mn) : 96.9
M cap (INR bn/USD mn) : 4.5 / 109.2
Avg. Daily Vol. BSE/NSE ('000) : 116.7

Share Holding Pattern (%)

Promoters : 51.5
MFs, FIs & Banks : 2.4
FIs : 0.3
Others : 45.8

Financials

Year to March	Q4FY08	Q4FY07	Y-o-Y (%)	Q3FY08	Q-o-Q (%)	FY07	FY08*
Net revenue (INR mn)	1,943	1,765	10.1	1,720	13.0	5,808	6,835
EBITDA (INR mn)	103	211	(50.9)	183	(43.4)	600	622
Adj. net profit (INR mn)	11	110	(90.0)	73	(85.0)	277	251
EBITDA margins (%)	5.3	11.9		10.6		10.3	9.1
PAT margins (%)	0.6	6.3		4.3		4.8	3.7
EPS (INR)	0.1	1.1	(90.0)	0.7	(85.0)	3.0	2.6
P/E (x)						15.0	17.4
EV/EBITDA						8.0	7.7
ROE (%)						25.5	16.1
ROCE (%)						24.0	17.2

* sum of four quarters

* Key highlights

In terms of business outlook, sales of Hyundai *i10* have eaten into the volumes of Hyundai *Santro*, and to a small extent for *Alto* and *Wagon R*. Sona supplies to all three models, but does not cater to the *i10*, leading to a minor loss in revenue from that sub-segment. It has, however, received additional orders from Tata Motors, Mahindra and Mahindra, and Maruti Suzuki totaling INR 1 bn per annum during the quarter, and is continuing its diversification amongst domestic customers.

In terms of exports, Sona has exported components worth INR 630 mn in FY08, of which INR 73 mn is to its JV partner Fuji Autotech Europe (FAE) as a tier-II supplier. This is likely to gain momentum over FY09-10E.

Financial snapshot									(INR mn)
Year to March	Q4FY08	Q4FY07	Growth (%)	Q3FY08	Growth (%)	Q2FY08	FY07	FY08*	FY09E
Total net revenue	1,943	1,765	10.1	1,720	13.0	1,646	5,808	6,836	8,182
Dec/(inc) in stock	33	25		(10)		(0)	0	11	0
Raw material	1,487	1,266		1,248		1,188	4,509	5,040	6,328
Staff cost	135	113		134		115	385	494	567
Other expenses	185	151		166		167	314	668	387
Total expenditure	1,840	1,555	18.3	1,538	19.6	1,469	5,208	6,213	7,281
EBITDA	103	211	(50.9)	183	(43.4)	177	600	623	901
Interest	37	22	70.8	29	25.5	28	87	115	174
Depreciation	55	32	74.7	45	22.1	36	124	171	231
Other income	10	6	70.2	7	40.6	7	27	30	30
PBT	21	163	(87.2)	115	(81.8)	120	416	367	526
Tax	10	52		42		48	139	143	175
Net profit	11	111		73		72	277	224	351
Extraordinary items	0	1		0		(16)	0	(28)	0
Adjusted net profit	11	110	(90.0)	73	(85.0)	88	277	252	351
Tax rate	45.5	31.7		36.3		39.8	33.3	38.9	33.3
% of net revenues									
Raw material	78.2	73.1		72.0		72.2	77.6	78.6	77.3
Staff cost	6.9	6.4		7.8		7.0	6.6	7.2	6.9
Other expenses	9.5	8.5		9.6		10.1	5.4	5.0	4.7
EBITDA	5.3	11.9		10.6		10.7	10.3	9.1	11.0
Interest	1.9	1.2		1.7		1.7	1.5	1.7	2.1
Depreciation	2.8	1.8		2.6		2.2	2.1	2.5	2.8
Other income	0.5	0.3		0.4		0.4	0.5	0.4	0.4
Net profit (adjusted)	0.6	6.3		4.3		5.3	4.8	3.7	4.3

* sum of four quarters

Company Description

Sona Koyo is a leading supplier of steering solutions in India, promoted jointly by Dr. Surinder Kapur and JTEKT Corporation, Japan (erstwhile Koyo Seiko Co.—the world's largest steering systems manufacturer). It is India's largest steering gears maker with 45% market share in steering systems for passenger cars and manufactures various products like column type electronic power steering (CEPS), hydraulic power steering, manual power steering, and drive line parts, catering to both passenger cars and MUV sectors. JTEKT and Maruti Suzuki hold 20.1% and 7.85% stake, respectively, in the company.

The company has grown on the back of strategic financial and technological JVs with global market leaders in steering solutions. Besides its core JV with JTEKT, Sona Koyo has entered into a strategic JV with the Fuji Kiko Group, the market leader of steering columns in Europe, to gain a foothold in the European and Latin American markets.

Investment Theme

Sona Koyo is investing INR 4 bn over FY07-10E to expand its capacities, along with setting up two new plants, one each at Singur and Uttaranchal. It is also investing in increasing the level of localisation for its fastest growing product, CEPS. This will help improve margins in FY08E and FY09E, as only 5% of the raw material for CEPS is currently indigenised.

Its exports to Europe are likely to gain momentum on the back of its JV with Fuji Autotech Europe (FAE). It has started supplying components such as ball pins, steering column ball bearings, fasteners, and sheet metal components like control arms, brackets, and recliners to FAE as a tier-II supplier.

Sona will be supplying 50% of the steering requirements for the Tata *Nano*, along with 100% of the differentials. It is rapidly gaining traction as the preferred supplier for steering solutions for the small car segment and has managed to bag orders of over INR 3.0 bn from marquee clients like Toyota and Hyundai.

Key Risks

- Competition from new entrants could dampen growth and add to margin pressure.
- Rapid currency appreciation could dampen export growth.
- Raw material price fluctuations could add to margin pressures.

Financial Statements

Income statement					(INR mn)
Year to March	FY06	FY07	FY08E	FY09E	FY10E
Income from operations	3,397	5,808	6,835	8,182	9,744
Direct costs	2,537	4,509	5,375	6,328	7,458
Employee costs	280	385	493	567	658
Other expenses	203	314	345	387	464
Total operating expenses	3,020	5,208	6,213	7,281	8,579
EBITDA	377	600	622	901	1,165
Depreciation and amortisation	107	124	170	231	279
EBIT	269	476	452	670	886
Interest expenses	51	87	116	174	213
Other income	32	27	30	30	30
Profit before tax	251	416	366	526	703
Provision for tax	88	139	143	175	234
Extraordinary items	-	-	(28)	-	-
Minority interest			0.0	0.0	(2.9)
Adjusted net profit	163	277	251	351	466
Shares outstanding	44.0	92.3	96.9	99.4	99.4
Dividend per share	1.0	0.7	0.7	0.8	1.0
Dividend payout (%)	27.0	24.5	27.5	24.0	22.0

Common size metrics- as % of net revenues

Year to March	FY06	FY07	FY08E	FY09E	FY10E
Operating expenses	88.9	89.7	90.9	89.0	88.0
Depreciation	3.2	2.1	2.5	2.8	2.9
Interest expenditure	1.5	1.5	1.7	2.1	2.2
EBITDA margins	11.1	10.3	9.1	11.0	12.0
Net profit margins	4.8	4.8	3.7	4.3	4.8

Growth metrics (%)

Year to March	FY06	FY07	FY08E	FY09E	FY10E
Revenues	14.2	71.0	17.7	19.7	19.1
EBITDA	10.4	59.3	3.7	44.8	29.3
PBT	(1.0)	65.8	(12.0)	43.9	33.6
Net profit	(2.4)	70.4	(9.4)	39.8	32.8
EPS	(2.4)	70.4	(13.7)	36.4	42.9

Cash flow statement					(INR mn)
Year to March	FY06	FY07	FY08E	FY09E	FY10E
Net profit	163	277	223	351	466
Add: Depreciation	107	124	170	231	279
Add: Misc expenses written off	(12)	34	15	-	-
Add: Deferred tax	13	16	57	-	-
Gross cash flow	271	451	466	582	745
Less: Dividends	50	79	81	99	120
Less: Changes in W. C.	14	(96)	(189)	126	164
Operating cash flow	207	468	574	357	461
Less: Change in investments	1	1	215	-	-
Less: Capex	387	666	1,330	1,200	804
Free cash flow	(181)	(199)	(970)	(843)	(343)

Balance sheet					(INR mn)
As on 31st March	FY06	FY07	FY08E	FY09E	FY10E
Equity capital	88	185	194	199	199
Reserves & surplus	753	1,149	1,600	2,011	2,357
Shareholders funds	841	1,334	1,794	2,209	2,556
Secured loans	1,052	955	1,155	1,655	1,655
Unsecured loans	4	4	700	700	1,000
Borrowings	1,056	959	1,855	2,355	2,655
Sources of funds	1,897	2,293	3,650	4,565	5,211
Gross block	2,042	2,315	3,759	4,787	5,927
Depreciation	826	939	1,109	1,340	1,618
Net block	1,215	1,376	2,651	3,448	4,309
Capital work in progress	78	459	344	516	181
Total fixed assets	1,293	1,835	2,995	3,964	4,489
Investments	298	299	514	514	514
Inventories	242	305	262	448	534
Sundry debtors	410	811	712	897	1,068
Cash and equivalents	16	15	259	79	35
Loans and advances	257	307	399	498	623
Other current assets	24	21	21	21	21
Total current assets	949	1,458	1,652	1,943	2,280
Sundry creditors and others	464	1,036	1,157	1,340	1,480
Provisions	65	98	116	278	356
Total CL & provisions	529	1,134	1,274	1,619	1,836
Net current assets	420	324	378	324	445
Net deferred tax	(194)	(209)	(267)	(267)	(267)
Others	79	45	30	30	30
Uses of funds	1,897	2,293	3,650	4,565	5,211
Book value per share (BV) (INR)	19	14	19	22	26

Ratios

Year to March	FY06	FY07	FY08E	FY09E	FY10E
ROE (%)	20.7	25.5	16.1	17.5	19.6
ROCE (%)	17.2	24.0	17.2	17.0	18.7
Current ratio	1.8	1.3	1.3	1.2	1.2
Debtors (days)	44	51	38	40	40
Fixed assets t/o (x)	2.9	3.7	2.8	2.4	2.3
Debt/Equity	1.3	0.7	1.0	1.1	1.0

Valuations parameters

Year to March	FY06	FY07	FY08E	FY09E	FY10E
EPS (INR)	1.8	3.0	2.6	3.5	5.0
Y-o-Y growth (%)	(2.4)	70.4	(13.7)	36.4	42.9
CEPS (INR)	6.1	4.3	4.3	5.9	7.5
P/E (x)	25.6	15.0	17.4	12.7	8.9
Price/BV(x)	2.4	3.1	2.4	2.0	1.7
EV/Sales (x)	1.4	0.8	0.7	0.6	0.5
EV/EBITDA (x)	12.7	8.0	7.7	5.3	4.1

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Coverage group(s) of stocks by primary analyst(s): Auto/Auto Components:

Ashok Leyland, Tata Motors, Bajaj Auto Ltd, Maruti Udyog, Mahindra & Mahindra, Hero Honda Motors, TVS Motor, Bharat Forge, Amtek Auto, Amtek India, and Hinduja Foundries.

Sona Koyo Steering Systems



Recent Research

Date	Company	Title	Price (INR)	Recos
17-Apr-08	Auto Sales Update			<i>Monthly Update</i>
16-Apr-08	Auto Components			Q4FY08 earnings preview; <i>Result Preview</i>
15-Apr-08	Automobiles			Q4FY08 earnings preview; <i>Result Preview</i>
31-Mar-08	Amtek Auto			Tremors from forex derivatives; <i>Visit note</i>

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Accumulate	Reduce	Sell	Total
Rating Distribution*	104	57	10	1	192

* 15 stocks under review / 5 rating withheld

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	85	76	31

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 20% over a 12-month period
Accumulate	appreciate up to 20% over a 12-month period
Reduce	depreciate up to 10% over a 12-month period
Sell	depreciate more than 10% over a 12-month period

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