

July 22, 2008

Rating	Underperformer
Price	Rs26
Target Price	Rs28
Implied Upside	7.7%
Sensex	14,104

(Prices as on July 22, 2008)

Trading Data

Market Cap. (Rs bn)	2.5
Shares o/s (m)	97.0
Free Float	48.5%
3M Avg. Daily Vol ('000)	20.9
3M Avg. Daily Value (Rs m)	0.7

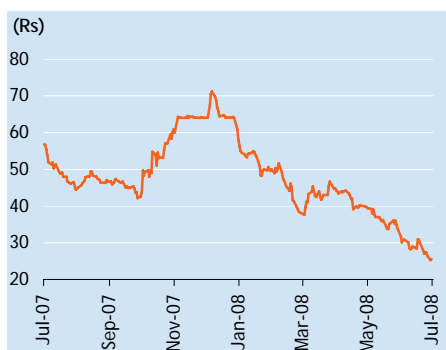
Major Shareholders

Promoters	51.5%
Foreign	0.3%
Domestic Inst.	2.4%
Public & Others	45.8%

Stock Performance

(%)	1M	6M	12M
Absolute	(24.2)	(55.8)	(54.9)
Relative	(21.0)	(40.1)	(45.5)

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



Source: Bloomberg

■ **Results:** Sona Koyo Steering Systems (SKSSL) reported 11.6% growth in net sales in Q1FY09 to Rs1.7bn. Rising steel costs and yen appreciation against the rupee resulted in 521bps decline in margins to about 5.6%. Absolute EBITDA for the quarter was down 42% YoY at Rs95m. Higher depreciation, rising interest burden (Rs52m in Q1FY09 against Rs8.5m in Q1FY08) coupled with lower margins, resulted in the company reporting a marginal loss for the quarter of about Rs0.8m.

■ **Capex plans:** Of the total Rs4bn capex lined up during the four-year period (FY07-10), Rs2bn was incurred by FY08 and a further Rs1.2bn is lined up for investment in FY09, while the balance Rs0.8bn was earmarked for investment in FY10. Most of the incremental capex is expected to be financed through debt, which is expected to increase the interest burden going forward. Of the new JVs formed by the company, only the American Axle JV being set-up in Uttarakhand for the Tata Ace is expected to commence operations by October 2008, while the other three JVs would be operational in FY10-11. SKSSL's Singur plant for the *Nano* is expected to be operational by Q3FY09.

■ **Valuation:** The company's localisation plans are running slightly behind schedule due to delay in customer approvals. The company management has given a revenue guidance of Rs8.2bn for FY09 and is targeting an operating margin of 11% for FY09. However, we feel that while the revenue guidance is achievable, margins would continue to be under pressure for the fiscal. The stock is currently trading at 9.3x FY09E EPS of Rs2.8 and at 6.8x FY10E EPS of Rs3.8. In the absence of any near term triggers, we downgrade to Underperformer.

Key financials (Y/e March)	FY07	FY08	FY09E	FY10E
Revenue (Rs m)	5,804	6,836	7,950	9,386
Growth (%)	70.9	17.8	16.3	18.1
EBITDA (Rs m)	618	635	808	1,014
PAT (Rs m)	277	252	270	367
EPS (Rs)	2.9	2.6	2.8	3.8
Growth (%)	70.5	(9.1)	7.2	35.8
Net DPS (Rs)	0.7	0.7	0.5	0.7

Source: Company Data; PL Research

Profitability & valuation	FY07	FY08	FY09E	FY10E
EBITDA margin (%)	10.6	9.3	10.2	10.8
RoE (%)	25.5	16.0	12.7	14.2
RoCE (%)	16.2	8.5	9.4	9.9
EV / sales (x)	0.57	0.63	0.64	0.57
EV / EBITDA (x)	5.3	6.7	6.4	5.3
PE (x)	8.5	9.8	9.2	6.8
P / BV (x)	1.8	1.4	1.0	0.9
Net dividend yield (%)	2.7	2.7	2.0	2.3

Source: Company Data; PL Research

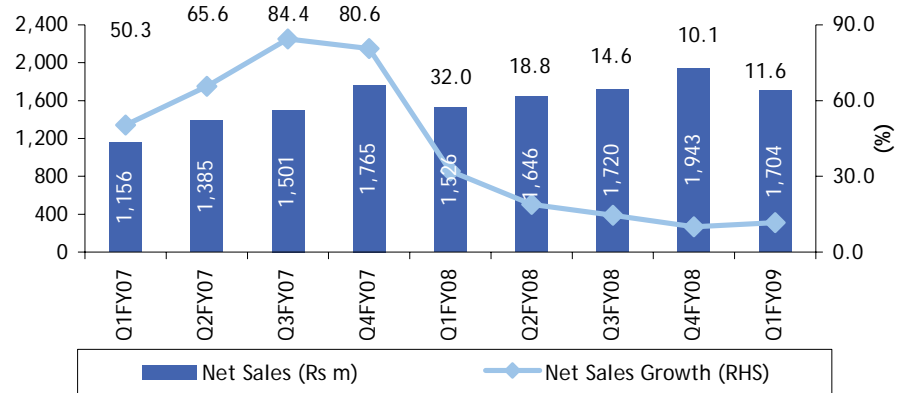
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Highlights

Growth in line with industry trend

SKSSL reported 11.6% topline growth to Rs1.7bn in Q1FY09, in line with the growth of the domestic passenger car segment to which it primarily caters. The domestic car segment has grown by about 12.3% YoY in the first quarter of the current fiscal. Growth in the segment was driven by its top two customers Maruti and Hyundai, which posted 13.5% and 39.5% growth in volumes respectively. Maruti, its top customer now, contributes about 49% to its revenue (57% in Q1FY08), Hyundai contributes about 15% (11% in Q1FY08) and M&M contributes about 11% (10% in Q1FY08) to its revenue. Domestic sales during the quarter was up 7.6% YoY to Rs1.5bn, while exports were up 54.7% YoY to Rs204.2m.

Growth slowing down

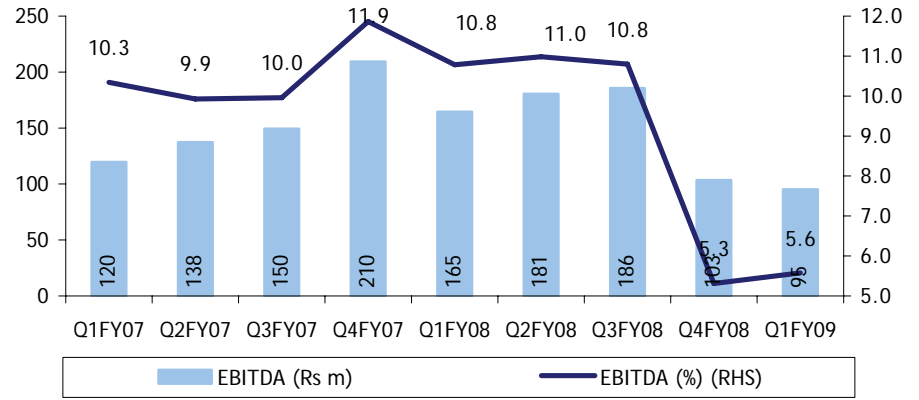


Source: Company Data, PL Research

Margin worries continue

The company's margins crashed 521bps YoY to 5.6%. Steel price increase and the adverse yen movement during the quarter took its toll on the company's operating performance. While the raw material cost push continued, the company has been able to get a pass-through from only about 10% of its customers. Also, the company had not hedged itself for the adverse yen movement. As a result, the company suffered a net forex loss of Rs20m during the quarter as against a net forex gain of Rs60m in Q1FY08. Adjusting for the forex impact, margins for the quarter were actually flat YoY at about 6.7%.

Adverse yen movement impacts margins



Source: Company Data, PL Research

SKSSL reports a loss

Absolute EBIDTA for the quarter was down 42% to Rs95m. Depreciation during the quarter was up 48% to Rs57.4m, while the interest burden was higher at about Rs52m (Rs8.5m in Q1FY08). As a result, the company reported a marginal loss of about Rs0.8m, adjusted for the Rs15.6m loss on foreign currency loan transaction.

Valuation

Of the total Rs4bn capex lined up during the four-year period (FY07-10), the company has planned a capex of Rs1.2bn in FY09 and the balance Rs0.8bn in FY10. Most of the incremental capex is expected to be financed through debt. SKSSL’s Singur plant for the Nano is expected to be operational by Q3FY09.

The company’s localisation plans are running slightly behind schedule due to delay in customer approvals. The company management has given a revenue guidance of Rs8.2bn for FY09 and is targeting an operating margin of 11% for FY09. However, we feel that while the revenue guidance is achievable, margins would continue to be under pressure for the fiscal. The stock is currently trading at 9.3x FY09E EPS of Rs2.8 and at 6.8x FY10E EPS of Rs3.8. In the absence of any near term triggers, we downgrade to Underperformer.



Q1FY09 result overview

(Rs m)

Y/e March	Q1FY09	Q1FY08	YoY gr. (%)	Q4FY08	QoQ gr. (%)
Net sales	1,704	1,526	11.6	1,943	(12.3)
Expenditure					
Raw material	1,293	1,105	17.0	1,520	(15.0)
<i>as % of net sales</i>	<i>75.9</i>	<i>72.4</i>		<i>78.2</i>	
Personnel cost	140	111	25.6	135	3.9
<i>As % of net sales</i>	<i>8.2</i>	<i>7.3</i>		<i>6.9</i>	
Mfg. expenses	176	146	21.2	185	(4.9)
<i>as % of net sales</i>	<i>10.3</i>	<i>9.5</i>		<i>9.5</i>	
Total expenditure	1,609	1,362	18.1	1,840	(12.6)
EBITDA	95	165	(42.3)	103	(8.0)
<i>EBITDA margin (%)</i>	<i>5.6</i>	<i>10.8</i>	<i>(521)</i>	<i>5.3</i>	
Depreciation	57	39	47.6	55	4.0
EBIT	38	126	(70.1)	48	(21.8)
Net interest	52	9	511.8	37	40.9
Non-operating income	10	6	60.7	9	5.4
PBT	(5)	123	(103.7)	21	(122.4)
Total tax	(4)	44	(108.7)	10	(140.0)
<i>Total tax rate (%)</i>	<i>-</i>	<i>35.3</i>		<i>46.3</i>	
Adj. profit after tax	(1)	80	(101.0)	11	(107.3)
Extraordinary items	(16)	-		-	
Reported profit	(16.4)	80	(81.5)	11	34.5



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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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