October 5, 2006

FOR PRIVATE CIRCULATION

Vinay Goenka
vinay.goenka@kotak.com
+91 22 6634 1291

Tube Investments of India

Price: Rs.83 **Recommendation: BUY**
Price target: Rs.118

Stock details

BSE code	:	504973
NSE code	:	TUBEINVEST
Market cap (Rs mn)	:	15,334
Free float (%)	:	57
52-wk Hi/Lo (Rs)	:	132/63
Avg. Daily Volume BSE	:	33114
Shares o/s (mn)	:	185
(Rs.2 paid up)		

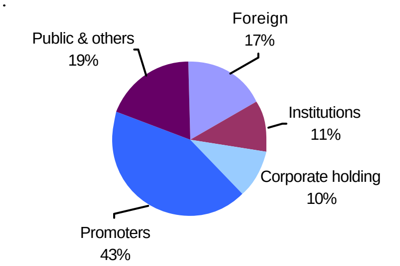
Summary table (Rs mn)

	FY06	FY07E	FY08E
Sales	14,609	16,138	19,014
Growth (%)	1	10	18
EBITDA	1,733	1,985	2,621
EBITDA margin (%)	11.9	12.3	13.8
Other Income	312	221	220
Net profit*	800	816	1,444
One time Income	1,029	713	
Net cash (debt)	(1,524)	(1,442)	(422)
Adjusted EPS (Rs)	4.3	4.4	7.8
Growth (%)	(18.8)	1.9	77.0
DPS (Rs)	5.4	1.3	1.5
ROE (%)	16.3	13.7	20.1
ROCE (%)	17.2	16.3	21.0
EV/Sales (x)	0.99	0.89	0.70
EV/EBITDA (x)	8.4	7.3	5.1
P/E (x)	19.2	18.8	10.6
P/BV (x)	2.9	2.3	2.0

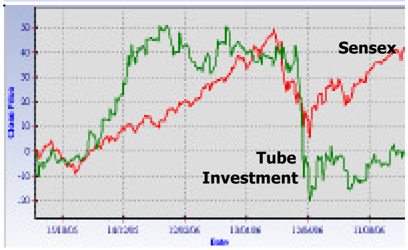
FY06/07	Q206	Q306	Q406	Q107
Sales (Rs mn)	3,547	3,691	3,588	3,815
EPS (Rs)	1.7	0.9	0.5	0.9

Source: Company & Kotak Securities - Private Client Research; * Excluding One-time income

Shareholding pattern as on 30 June 2006



One-year performance (Rel to sensex)



Source: Capitaline

Tube Investments of India (TII), the flagship company of the Murugappa group, is one of the leading players in India in precision tubes, doorframes, automotive chains and the bicycle industry. TII is the market leader in precision tubes and car doorframes and enjoys a strong relationship with leading OEMs like Maruti, Hyundai, Bajaj Auto, Hero Honda, Ford, GM and Honda. The company is aggressively expanding its capacity in the precision tubes and doorframes segments to address the strong market demand led by the auto industry. In two years, TII's consolidated tube capacity is expected to rise by 92%. It will be catering to both the domestic and overseas markets.

It is also setting up a new doorframe plant in Pune to cater to the requirements of Tata Motors. Given our positive outlook on the Indian auto industry we believe that post expansion the company stands to benefit both in terms of revenues and profitability. Besides, the company holds a 74% stake in Cholamandalam MS General Insurance and 30.93% equity holding in Cholamandalam DBS Finance that could provide value unlocking in the coming years. We initiate coverage on the stock with a price target of Rs.118 (42% upside) over a 12-month horizon based on SOTP valuations.

Key Investment Rationale

- **Benefits of incremental capacity in engineering segment from FY08:** In the precision tubes segment, the capacity is expected to increase by 92% by the end of FY08. Besides, the incremental tube capacity will focus on cold drawn welded (CDW) tubes, which command better realizations than electric resistant welded (ERW) tubes. In strips too, TII is focusing towards the specialty strips. Given the positive outlook for most of its application industries like bearings, automobile, auto ancillaries and general engineering, we believe the company will benefit from the expanded capacity in the coming years.

- **New car model launches to drive growth in doorframes:** During the current financial year, both Maruti and Hyundai are expected to launch one new model for which, according to the company, doorframes would be exclusively supplied by TII. The proposed new launches are expected to drive up revenues from this segment in the coming years. The company is also in the process of setting up a new car doorframe plant near Pune to cater to the requirements of Tata Motors.

- **Strong revenue visibility from the chains division:** Given that two-wheeler volumes are expected to grow by around 15%, going forward, the revenue visibility is strong. Besides, there is a sizeable replacement market for the product (in excess of 10 mn two-wheelers) and TII with its 'Diamond' chains should continue to record higher revenues.

- **Return ratios to benefit from increasing revenues from non-cycle growth segments:** To capitalize on its strong engineering capabilities, TII's capex plans over the next two years ending FY08 will focus on the growth areas of engineering and metal-formed segments. Currently the engineering division enjoys an RoI of 33% while metal-formed products command 28%. As the company ramps up the capacity, the combined share of the engineering and metal division would rise from the present 69% to 77% by FY09 leading to higher return ratios for the company.

- **Growth in revenues and profitability:** Although we expect the revenues to report a CAGR of 13% till FY09, we expect the EBITDA to grow at 19% CAGR over the same period as the company would benefit from shifting its focus towards high end products. The operating margins should expand in the coming years benefiting from better sales mix and higher capacity utilization. The entire capital expenditure planned by the company is expected to be funded entirely through internal accruals and there are no plans for equity dilutions.
- **Valuation:** At the current price of Rs.83, the stock is trading at 10.6x FY08E earnings and 5.1x on an EV/EBITDA basis. We believe the current valuations look attractive, given the future potential, based on the demand growth in the automobile industry and the capacity expansion of TII that would lead to growth in revenues and profitability going forward.

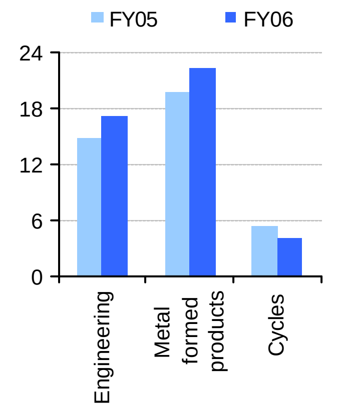
Key Risks

- **User industry concentration risk:** Over 60% of the revenues can be related to the auto sector and a slowdown would adversely affect revenues.
- **Model risk:** Doorframes related investments are generally model-specific. Failure of a model would render the assets non-performing ones.
- **Import risk:** Imports from China and other Asean countries and the possibility of reduction in import duties.

BACKGROUND

Tube Investments of India Limited (TII) is the flagship company of the South India-based Murugappa Group. It manufactures precision steel tubes and strips, car doorframes, automotive and industrial chains and bicycles. The company has 13 manufacturing/assembly units spread across the country. The products are categorized into three operating segments namely, engineering (steel tubes and strips), metal formed products (metal chains and car doorframes) and bicycles.

EBITDA Margins (%)

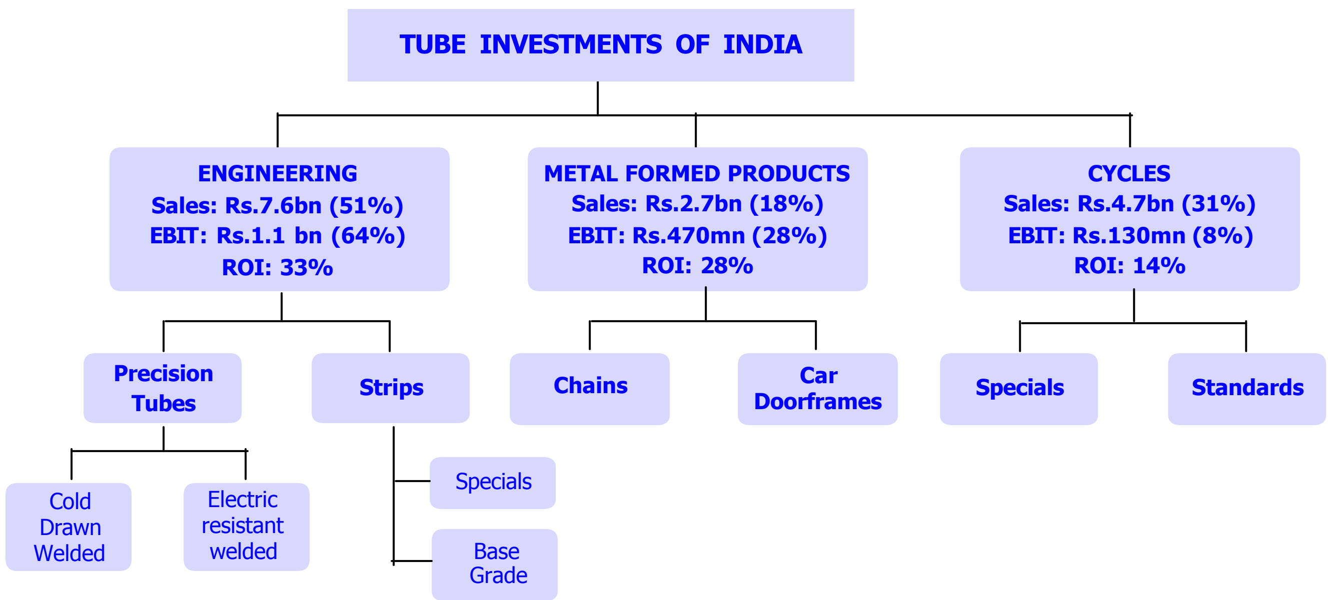


Source: Company

TII has successfully evolved its portfolio from cycle manufacturing to high-growth areas such as engineering and metal forming. It has also established an engineering design center (EDC) to complement its R&D initiatives in the field of new generation steels, processing and metal forming. The company also has strategic investments in the fast paced financial service sector. TII has a 30.93% equity holding in Cholamandalam DBS Finance Ltd, one of the leading NBFCs in India. In the insurance sector, Cholamandalam MS General Insurance Co Ltd is a 74% owned subsidiary of the company.

- TII is a pioneer and market leader in the high-end cold drawn welded (CDW) tubes with a 64% market share.
- It is a market leader in metal-formed car doorframes with 57% market share. It caters to a majority of auto manufacturers.
- TII is the second largest supplier of automotive chains to two-wheeler manufacturers with a major share of the replacement market. In industrial chains, it is a supplier to major chain manufacturers in Europe. Overall, it commands a 30% market share in this segment.
- In cycles, TII is the second-largest player in India and a leader in the 'specials' segment with 39% market share.

Business overview



Source: Company Presentation

TII currently generates 51% of its revenues from the engineering division, 18% from the metal-formed products while the cycle segment contributes the balance 31%. However, on the profitability front, the engineering division contributes around 64%, metal-formed products 28% and the cycle segment only 8%. Over the years, TII has successfully evolved its balanced portfolio, comprising high-growth areas such as engineering and metal forming, with an aggressive focus on auto applications along with a steady outlook on its bicycle business.

Business Profile

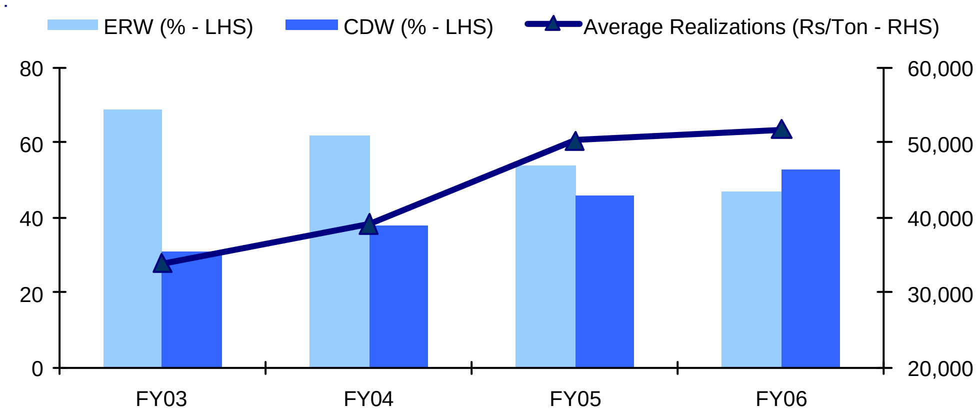
Engineering

Precision Tubes

The precision tube industry can be divided into two segments — welded and seamless tubes. TII focuses on the ferrous cold drawn welded (CDW) and electric resistant welded (ERW) tubes that find application in the automotive, boiler, cycle and general engineering sectors. The size of the addressable precision tube market for TII in India is currently estimated to be around 325,000 tons per annum.

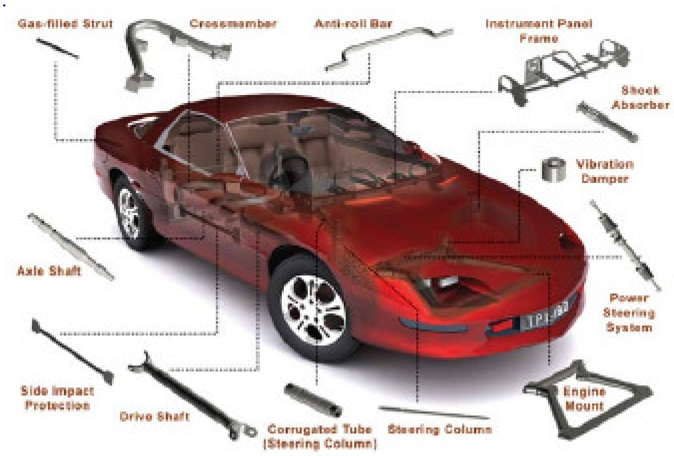
There are four major players in the market and TII is the pioneer in the critical auto applications segment. The growth in this business is directly proportionate to the fortunes of the auto sector with two-wheelers being the biggest demand driver. Over the last few years, the company has been focusing on increasing turnover from CDW and high-engineered ERW tubes, which command higher realizations. The share of CDW in TII's tube sales has risen from 31% in FY03 to 53% in FY06 leading to higher realizations from the segment.

Average Realizations



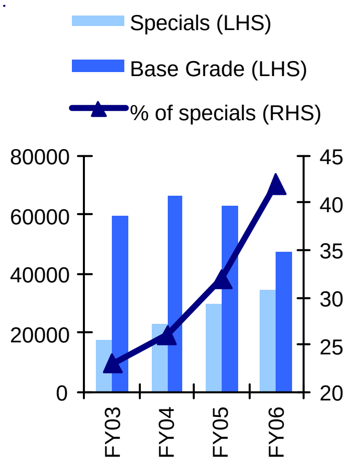
Source: company (presentation)

Application of tubes in auto industry



Source: Company (website)

Strips product mix (tons)



Source: Company (presentation)

Strips

Steel strips comprise narrow (below 350 mm) and wide (350 mm to 1000 mm) width categories. The user industries are automobiles, bearings, cycles, fine blanking, stamping, chains and general engineering. The size of TII's addressable market is estimated to be around 1,200,000 tons per annum according to the management. The industry has about 10 players, each with a regional focus due to the high freight costs. TII has a dominant share in southern India.

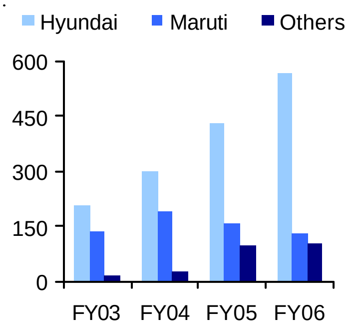
While integrated steel mills have an advantage in terms of costs and volumes, TII's ability to handle a variety of grades and sizes with lower volumes enables it to maintain its position. The company has realigned the production of wide width and narrow width strips at a capex of Rs.130 mn to achieve better production planning, inventory management and reduction on overheads. Since the majority of the competition exists in the base grade, TII has shifted its focus towards specialty strips that are primarily consumed for internal sheet components of automotives, seat assembly, engine mounts and doorframes. As a result, the share of specials in TII's strips product mix has risen from 23% in FY03 to 42% in FY06.

Metal Formed products

Metal forming is a multi-faceted industry. TII is engaged in the manufacture of chains, cold roll forming of car doorframes and fine blanked components.

Chains can be further categorized into automotive and industrial chains. TII is one of the major suppliers of automotive chains for two-wheelers in India. Automotive chains are also marketed through a wide dealer network in the replacement market. Industrial chains cater to the needs of the cement, fertilizer, steel, sugar, elevators and power transmission industry in general. Currently, export volumes from India are low given the size of the global market and TII is looking at tapping such opportunities in the future.

Doorframe sales trend (Rs mn)



Source: Company (presentation)

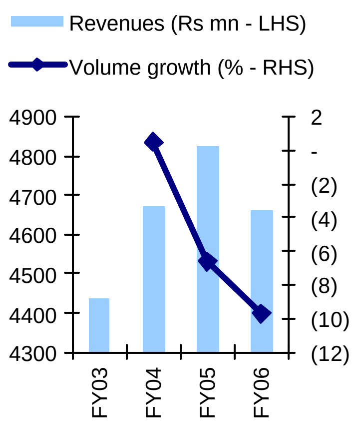
Car door frames

Pioneer in cold forming doorframes, TII is in the business of manufacturing and supplying value-added, metal-formed auto components to OEMs. It became the first supplier of doorframes in India. In roll forming, TII's focus is on the manufacture of model specific car doorframes. It is one of the two major independent players in India for roll formed car doorframes.

Success here is directly associated with the success of the car models being serviced by the company. TII's first greenfield doorframe manufacturing facility was set up in 1998 at Bawal, near Gurgaon, in technical collaboration with M/s Edward Rose of UK, for the supply of 800cc doorframes to Maruti Udyog Ltd. The second facility for manufacturing doorframes was also set up in 1998 at Thiruninravur near Chennai, in technical collaboration with M/s Dongwon of Korea, to supply doorframes for Santro and Accent models of cars to Hyundai. Currently, its customers include Hyundai (Santro and Accent), Maruti (Omni and 800), GM (Tavera) and Visteon India.

In fine blanking, TII manufactures sprockets, power-transmission related products and other auto components. Fine blanking is considered a high potential business although the current market size offers limited opportunities.

Cycle sales: Negative growth



Source: Company (Annual report)

Cycles

India is the second largest manufacturer of bicycles in the world with an annual production of 9-10 mn bicycles. Though the bicycle industry in India is largely organized, the presence of smaller players in the unorganized sector has been increasing. There are three major players in the organized sector namely TII, Hero and Atlas which cater to 85% of the market demand.

Cycles can be classified into two segments — standards and specials. The standard cycles are used for light transportation of humans and goods. Special category cycles are differentiated by design and features and cater to the new generation consumers as well as health and leisure segments. TI cycles are the makers of country's most famous brands like Hercules, BSA and Philips cycles. TII is the market leader in the specials category with around 39% share.

Overall, the organized sector of the bicycle industry has witnessed a decline in demand growth in the past few years. Increased urbanization, improved public transport and increased affordability of motorized vehicles are the primary causes for this downward trend. Another major factor affecting the industry is the non-availability of road space for bicycles.

In-house R&D with proven capabilities

R&D initiative further strengthened by TII becoming a member of an international steel consortium

R&D: The corporate research & development (R&D) function at TII is a fully operational testing laboratory and proving workshop. A total of 10 engineers manage the center and they are working on business driven R&D projects with specific focus in 'forming' and 'thermal processing'. The company had filed applications for three patents in 2005-06. The R&D initiative was further strengthened by TII becoming a member of an international steel consortium (Advanced Steel Processing and Products Research Center, Colorado School of Mines, USA).

This consortium is specifically focused on research work pertaining to advanced high strength steels for automotive applications. It has, as its member, 26 internationally recognized companies in steel, steel processing and automotive industries.

The outcome of R&D initiatives carried out over the last two years has culminated in the identification of new business opportunities to develop high strength steel tubular parts in automobile. Recently, the company had invested Rs.120 mn for adopting the 'dual phasing' technology for tubular applications.

Investment positives

Major expansion plans in the growth segments to drive future growth

Precision tubes: TII has embarked on a major expansion plan in the tubes segment in a phased manner over a period of three years, ending FY08. The domestic production capacity is expected to expand from 48,000 TPA to 72,000 TPA by the second half of the current financial year. The expansion plans were delayed by one year due to a delay in getting clearance from the pollution board, which could only be obtained in February '06. However, the capacity enhancement plans are back on track and are expected to start delivering results from FY07.

The consolidated tube capacity of TII will rise from the current 62,400 TPA to 120,000 TPA by the end of March '08, a rise of 92% in two years

The target size of the world market for precision tubes exports is estimated to be around 730,000 TPA with the Asia Pacific region being the biggest market at 375,000 TPA. In order to increase export revenues, TII is focusing on North America, Europe and Asia Pacific. It is in the process of opening an Regional Development Centre (RDC) in the US and Thailand in the current year.

The company is also focusing on expanding the export capacity from 14,400 TPA to 36,000 TPA in two phases. The export capacity will increase to 22,000 TPA by the end of FY07 and scale up to 36,000 TPA by the end of March '08.

TII has also announced a greenfield plant in China with a capacity of 12,000 tons to capitalize on the market potential for CDW tubes in China. The plant would be put up in Suzhou Industrial Park at an estimated cost of US$6.5 mn. According to the management, this plant should be commissioned by the end of the current financial year.

Planned expansion for precision tubes

Target Market (TPA)	Current size	Expansion	Completion date
Domestic	48000	24000	FY07
Exports	14400	7600	FY07
		14000	FY08
China (Greenfield plant)		12000	FY07
Total Capacity	62400	57600	

Source: Company (presentation)

As a result of the expansion drive, the consolidated tube capacity of the company will increase significantly from the current 62,400 TPA to 120,000 TPA by the end of March '08, an increase of 92% in two years.

Doorframes: TII is also in the process of setting up a new car doorframe plant near Pune to cater to the requirements of Tata Motors. The management expects the plant to commence operations in FY08 and we expect revenues from this new plant to match that generated from its Maruti operations. Besides this, the existing plants are also geared to take up the manufacture of new car models of existing customers after the scheduled expansion.

Another investment by the company is in hydro forming project at Kakkalur where it has plans to spend 310 mn by FY07. Hydro forming is shaping metal by keeping it on a die and applying water pressure. This obviates the need for heating, which is otherwise necessary for forming metal. Heating distorts chemical properties. Besides, hydro forming is more cost effective, because it helps save on the heating costs.

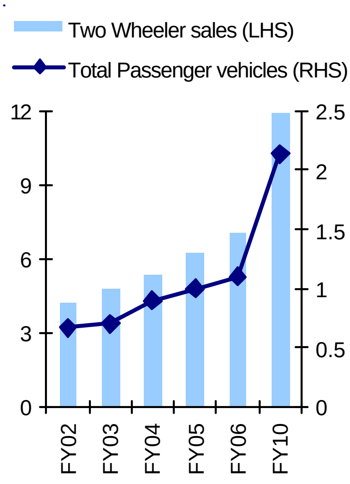
In this category, the company is focusing on auto component requirements involving intricate value-based designs like fuel tank and long arm. Both products have been submitted to OEMs and the company is awaiting approval from the manufacturers to commence supplies. Centered around its core competence of metal forming and synergizing with other business units, TII is poised for growth in value-added metal forming auto components such as exhaust system parts, body and structural parts/ assemblies etc.

Capex plans (Rs mn)

Precision Tubes	FY06	FY07	FY08
Tubes capacity expansion	360	410	200
Modernization	80	550	
High strength tubular component	70	130	
Strips- Integration of NW/WW mills	100	30	
Total	610	1120	200
Metal formed products			
Hydro forming projects	60	250	
New door frames	190	560	
Equipment for quality & productivity	210	270	
Total	460	1080	
Total Capex for Tube Investment	1070	2200	200

Source: Company (presentation)

Automobile Industry growth: On a sound Footing (mn units)



Source: Cris Infac

High domestic visibility in the application areas: To ensure sustained demand for TII

Automobiles generate over 60% of the company's revenues and the sector has shown impressive growth over the last few years. Going forward, we expect the sector to continue to grow at a steady pace over the next three to four years, ensuring revenue visibility for TII's products. The overall two-wheeler demand is expected to rise at a CAGR of 14% to 11.9 mn units by 2009-10.

Growth will be driven by the expected surge in demand for motorcycles and ungeared scooters. The expected rise in household income, easy availability of consumer finance, growing replacement demand, frequent introduction of newer trendy models by players and growing aggressiveness by key players will fuel two-wheeler growth in the long-term.

The car industry has also grown at an impressive rate of 13% in the last four years and the annual domestic sales of passenger vehicles (UVs) is expected to accelerate to nearly 2.14 mn in 2009-10. Both Maruti and Hyundai have aggressive plans lined up in the coming years that will benefit TII given its strong relationship with these companies. Hyundai Motors plans to increase its plant capacity to 600,000 units by October 2007 from the existing 300,000 units.

Domestic car production capacity

(Nos)	Current	Planned
Maruti	6,00,000	10,00,000
Hyundai	3,00,000	6,00,000
Tata motors	2,25,000	6,00,000
M&M	50,000	1,50,000
Honda	50,000	1,50,000
Toyota	60,000	2,60,000
GM	80,000	2,20,000

Source: Industry (press/Cris Infac)

Besides new launches, it is also planning variants of existing models like Accent to expand volumes. Maruti has announced new plans to achieve its target of 1 mn units by 2010. It is also planning to introduce five new models in the next five years. Besides, given the domestic growth new players are looking to establish a presence in the domestic market. All these augur well for the future prospects of TII's various divisions going forward.

Degrowth in cycle segment to continue: Hit on profitability to be marginal

The company has been witnessing declining cycle volumes for the last two years in line with the industry's performance. We expect degrowth to continue this year too before bottoming out. Although the cycle segment contributes around 31% of the company's total revenues, the contribution to PBIT is only 8%. So, despite further declines, TII will not be significantly affected in terms of overall profitability.

Moreover, the segment is making cash profits and, going forward, the share of the cycle segment will further come down once the incremental capacities in other segments get fully commissioned. We expect the share of the cycle division to reduce to 22% of overall sales in FY08 from the current levels of 31%. In addition, TII is also looking at various initiatives to improve the efficiency of the segment.

For example, the company has been able to reduce outstanding from 65 days in March '05 to 42 days in March '06. It is also focusing on quality of sales instead of volumes and improving the ambience of the retail outlets. We believe the initiatives taken by the company would lead to improved cash flows and better margins despite falling volumes.

JVs and subsidiary may provide value unlocking in future

TII holds a 74% stake in Cholamandalam MS General Insurance Co, which achieved a gross written premium of Rs.2.2 bn (PY Rs.1.69 bn) for FY06. Although the subsidiary is at present making losses it is expected to turn around by the end of the current year. We have not included the valuations for the insurance business in our valuations but it can lead to substantial benefits in the future as the company starts making profits.

TII also has a 30.93% equity holding in Cholamandalam DBS Finance Ltd, one of the leading NBFCs in India. Cholamandalam DBS Finance Ltd is a joint venture between Murugappa Group and DBS Bank of Singapore and one of India's largest domestic NBFCs with a gross asset base (including securitized assets) of over Rs.20.75 bn. At the CMP of Rs.145, and awarding discount of 20% we get a valuation of Rs.7 per share of TII.

Q1 Result Analysis

(Rs mn)	Q107	Q106	chg (%)
Gross Sales	4135	4109	0.6
Excise Duty	320	327	-2.0
Net Sales	3815	3781	0.9
Other Income	11	10	12.6
One Time Income	713		
Total Income	4539	3792	19.7
Total Expenditure	3385	3335	1.5
OPM (%)	11.3	11.8	
PBIDT	429	446	-3.7
Interest	30	31	-1.2
PBDT	399	415	-3.9
Depreciation	137	114	20.1
PBT	262	301	-13.0
Tax	98	64	53.3
Fringe Benefit Tax	4	5	-26.9
Deferred Tax	-10	8	-234.6
PAT	170	234	-27.3
One Time Profit	713	0	
Adjusted EPS	0.92	1.26	-27.3

Source: Company & Kotak Securities - Private Client Research

Q1FY07 results

1QFY07 sales of Rs.4.1 bn are marginally higher than the corresponding quarter of the previous year. The profit before tax was at Rs.262mn as compared to Rs.301 mn in the previous year. The operating margins were also lower at 11.3% as compared to 11.8% in the previous year. Higher raw material costs and delay in price hikes by the OEMs was the reason behind the lower margins. However, the company has already effected a price hike and margins should improve in the coming quarters.

The revenue of the engineering business (precision tubes and strips) was marginally lower compared to the corresponding quarter of the previous year (Rs.1.91 bn vs Rs.1.99 bn). This marginal drop in sales was primarily due to lower volumes in exports, and some unforeseen disruptions in raw material supply chain. The company is currently in the process of re-organizing its tubes marketing network in the Nafta region, the benefits of which can be expected to flow from the third quarter onwards.

In doorframes, the overall offtake was good, despite a marginal drop in the demand of certain models. In the chains segment, the volumes of automotive chains as well as industrial chains registered significant growths. Exports of industrial chains were also higher than the corresponding quarter of the previous year. Overall sales in this business grew by 20% (Rs750mn vs Rs626mn). However, sales in the cycle segment were marginally lower in the absence of any institutional sales during this specific period (Rs.1.25 bn vs Rs.1.29 bn)

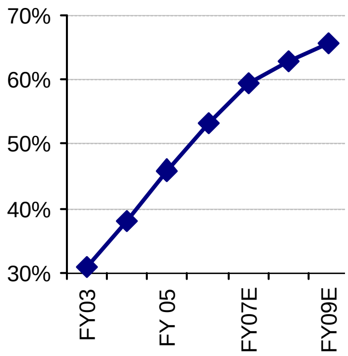
INVESTMENT ARGUMENTS

Benefits of incremental capacity in engineering segment from FY08

The company has lined up capex plans of Rs.1.93 bn over a three-year period ending FY08 in the engineering segment. In the precision tubes segment, the capacity is expected to rise 92% by the end of FY08. In addition, the incremental tube capacity will focus on CDW tubes, which command at least 15-20% higher realizations than ERW tubes.

In strips, too, TII is focusing on specialty strips. Although the company is not expanding capacity in this segment the change in product mix would improve the profitability of the segment, going forward. Overall, given the positive outlook for most application industries like bearings, automobile, auto ancillaries and general engineering, we believe the company will benefit from the expanded capacity in the coming years.

Share of CDW (% of total tube sales)



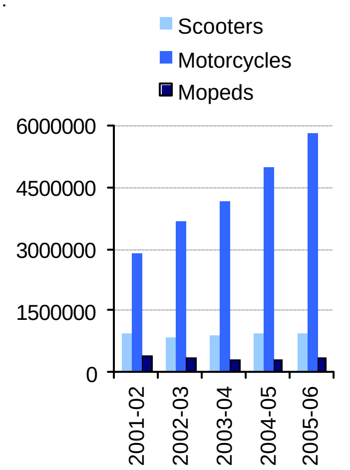
Source: Company, Kotak Securities - Private Client Research

New car model launches to drive growth in doorframes

At present, TII's major customers include Maruti (Omni and 800), Hyundai (Santro and Accent) and GM (Tavera). During the current financial year, both Maruti and Hyundai are expected to launch one new model for which doorframes would be exclusively supplied by TII. The proposed new launches will definitely drive up the revenues from this segment in the coming years.

The company is also in the process of setting up a new car doorframe plant near Pune to cater to the requirements of another major car manufacturer. The management expects the plant to commence operations in FY08 and we expect revenues from the new plant to match that from its Maruti operations. For FY07E, we expect TII to earn Rs.145 mn from Maruti's operations and the revenues from the new plant should be of similar range. However, ultimate revenues from the doorframe segment would depend on the success of the car models.

14% CAGR Growth in the domestic two-wheeler industry (Nos)



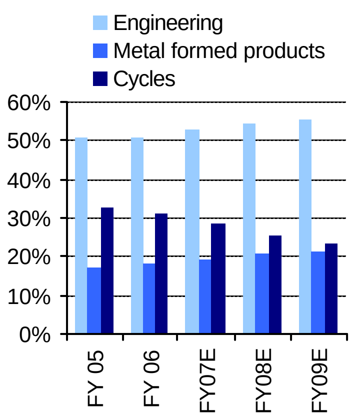
Source: SIAM Website

Strong revenue visibility from chains division

TII's revenues from automotive chains have benefited from the strong growth being witnessed by the two-wheeler industry. Given that two-wheeler volumes are expected to grow by around 15% going forward revenue visibility looks strong. The motor cycle chains needs to be replaced after 60,000 km and given that the domestic two-wheeler industry has grown by 14% CAGR in the last five years, there is a sizeable replacement market for the product (in excess of 10 mn two-wheelers) and TII with its 'Diamond' chains should continue to record higher revenues.

The growth in industrial chains is linked with the growth of the capital goods industry and given the favorable outlook for the sector TII will continue to generate higher volumes. Besides, the management is looking at new export markets like Asean and North America to drive revenues in the export market. TII has recently opened a warehouse in North America to meet customer demand.

Changing revenue mix (% share)



Source: Company, Kotak Securities - Private Client Research

Return ratios to benefit from higher revenues from non-cycle growth segments

Currently, cycles contribute to 31% of the company's turnover although EBIT is much lower at 8%. The segment has been recording negative volume growth in the last two years and has an RoI of only 14% as against 33% for the engineering division and 28% for the metal formed products. To capitalize on its strong engineering capabilities TII's capex plans of Rs.3.47 bn over three years ending FY08 will focus on the growth areas of engineering and metal-formed segments. We expect the revenues from the cycle division to further fall over the coming years (23% in FY09) resulting in higher RoE and RoCE.

Investments in new products to diversify revenue stream

TII has lined up Rs.200 mn as capital expenditure in high strength tubular components over two years ending FY07. The unit will focus on four wheeler tubular components like drive shaft axle, steering column and axle stabilizer bar. According to the management, the addressable market size for such products is Rs.2 bn. TII expects a potential turnover of Rs.400 mn in its first full year of operation, that is, FY08. The company also expects to generate Rs.600 mn in revenues from its hydro forming project in its first full year of operations, that is, FY08. The company is also increasingly looking at revenues from non-door frames product like Railways, etc.

Key Assumptions (Revenue growth %)

	FY07	FY08	FY09
Tubes	16	28	14
Strips	9	12	11
Chains	13	13	13
Doorframes	12	31	16
Cycles	-5	1	0

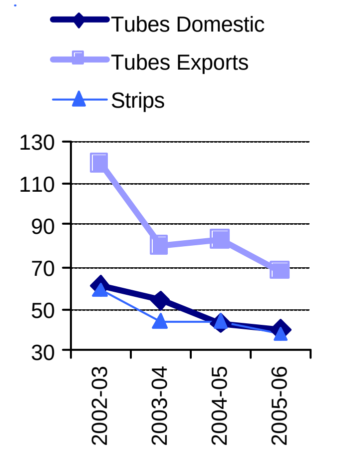
Source: Kotak Securities - Private Client Research

EARNINGS OUTLOOK

Revenue growth of 13% CAGR between FY06-09

We expect TII to record revenue growth at a CAGR of 13% between FY06-09, piggybacking on the higher capacity and favorable outlook for application industries like automobiles and engineering. We expect the company to achieve revenues of Rs.21 bn by FY09, an increase of 44% over Rs.14.6 bn recorded in FY06. While the cycle division is expected to post flattish growth, both engineering and metal-formed products are expected to drive growth once the ramp up in capacities takes place by the end of FY08.

Improvement in receivables (days)



Source: Company

Margins to benefit from changing revenue mix

Currently, cycles contribute to 31% of the company's turnover although EBIT is much lower at 8%. For FY06, the cycle division recorded EBITDA margins of 4% while the margins were much higher for engineering and metal-formed products (17% and 22%, respectively). Going forward, we expect that the revenue contribution of the cycle division will reduce to 23% in FY09 while the same will increase for engineering and metal-formed products to 55% and 22%, respectively. Also, the company will be focusing on higher end products, which yield better margins. As a result, we expect that operating margins will expand in the coming years in line with the changing sales mix.

Improving working capital cycle

In the last few years, TII has increasingly focused on improving its working capital cycle. It has managed to substantially reduce the receivables in all three segments resulting in overall debtor days declining from 79 in FY04 to 62 in FY06. In the coming years, we expect that the debtors cycle should stay at these levels as the share of exports in overall sales improve in the coming years.

VALUATION

At the current price, TII is trading at 18.8x and 10.6x FY07 and FY08 earnings, respectively. On an EV/EBITDA basis, the stock is trading at forward 5.1x FY08E. The outlook for the auto sector that accounts for 60% of TII's revenues is positive for the next few years. We expect TII to benefit from its expanded capacity from FY08 onwards once the capacity gets fully operational. TII has a strong balance sheet coupled with low debt levels.

Last year, the company saw volume decline in some products due to ongoing price negotiations. All the issues have been sorted out and the company even had selective price hikes in April '06. Upsides in earnings in future could come from the performance of the new model launches using its doorframes.

We have valued the company on a sum-of-parts basis over FY08 earnings. While the standalone operations at Rs.111 have been valued on a DCF basis the holding in Cholamandalam DBS Finance has been valued at Rs.7 based on 20% discount to the current market price. Accordingly, our price target works out to Rs.118 per share, achievable over a 12-month horizon. The stock is currently trading at Rs.83 and provides an upside of 42% from the current levels. We recommend a **BUY**.

DCF valuation

FCFF valuation per share (Rs mn)

Terminal value	12,525
Total FCFF	**19,666**
Less net debt (cash)	(835)
Shareholders' value	20,501
Value per share	**111**

Assumptions

Grth FY-10-12 (%)	10
Terminal Growth (%)	3.0
Beta	1.0
Risk Free Rate (%)	7.0
Market Risk Premium (%)	7.0
Cost of Equity (%)	14.0
Cost of Debt (%)	5.0
Debt	2,443
Equity	15,334
WACC (%)	12.6

Source: Kotak Securities - Private Client Research

Free Cash Flow to Firm

	FY06	FY07E	FY08E	FY09E	FY10E	FY11E	FY12E
PAT	**800**	**816**	**1,444**	**1,686**	**1,855**	**2,040**	**2,244**
One Time Income	1,029	713					
Depreciation	486	611	665	684	739	798	862
Interest	74	122	107	80	72	65	58
Capex	1,187	1,695	600	66	370	399	862
Change in NWC	(862)	118	207	138	154	173	193
Investments	462	-	-	-	-	-	-
FCFF	**1,604**	**449**	**1,409**	**2,247**	**2,142**	**2,331**	**2,109**
Discounted Value	1,604	449	1,251	1,772	1,501	1,451	1,166

Source: Kotak Securities - Private Client Research

Key Risks

- **User industry concentration risk:** Over 60% of the revenues can be related to the auto sector and a slowdown would adversely affect revenues.
- **Model risk:** Doorframes related investments are generally model-specific. Failure of a model would render the assets non-performing ones.
- **Import risk:** Imports from China and other Asean countries and the possibility of reduction in import duties.

Profit and loss statement (Rs mn)

(Year-end Mar)	FY06	FY07E	FY08E
Net Sales	**14,609**	**16,138**	**19,014**
Growth (%)	0.8	10.5	17.8
EBIDTA	**1,733**	**1,985**	**2,621**
Interest	132	122	107
EBDTA	1,601	1,863	2,514
Depreciation	486	611	665
Other income	312	221	220
One Time Income	1,029	713	
EBT	2,456	2,185	2,070
Tax	627	656	626
Earnings After Tax (excluding one time income)	800	816	1,444
Adjusted EPS (Rs)	4.3	4.4	7.8
BVPS (Rs)	28.8	35.8	42.0
Dividend (%)	268	66	76

Cash flow statement (Rs mn)

(Year-end Mar)	FY06	FY07E	FY08E
PAT	800	816	1,444
One Time Income	1,029	713	
Depreciation	486	611	665
Change in NWC	862	(118)	(207)
Operating cash flow	**3,177**	**2,022**	**1,902**
Investments	(462)	-	-
Capex	(1,187)	(1,695)	(600)
Investment cash flow	**(1,648)**	**(1,695)**	**(600)**
Loans Raised	162	-	(600)
Dividend	(990)	(245)	(281)
Financial cash flow	**(828)**	**(245)**	**(881)**
Other adjustments	17	-	-
Change in Cash	718	82	420
Opening Cash	201	919	1,001
Closing Cash	919	1,001	1,421

Source: Company; Kotak Securities - Private Client Research

Balance sheet (Rs mn)

(Year-end Mar)	FY06	FY07E	FY08E
Shareholder's Equity	370	370	370
Reserves	4,952	6,236	7,399
Total Networth	5,321	6,605	7,768
Secured Loans	1,719	1,719	1,119
Unsecured Loans	725	725	725
Total Loans	2,443	2,443	1,843
Total Liability	**7,764**	**9,048**	**9,611**
Net Fixed Assets	3,016	4,404	4,340
Capital WIP	805	500	500
Investments	2,359	2,359	2,359
Inventory	1,657	1,724	1,980
Debtors	2,064	2,785	3,282
Cash Balance	919	1,001	1,421
Loans & Advances	619	650	683
Current Liabilities	3,007	3,686	4,222
Provisions	253	275	317
Net Current Assets	2,000	2,200	2,827
Net deferred tax assets	(415)	(415)	(415)

Ratio analysis

(Year-end Mar)	FY06	FY07E	FY08E
Debt-Equity Ratio (x)	0.5	0.4	0.3
Current Ratio (x)	1.7	1.6	1.6
Inventory Turnover (x)	9.3	9.5	10.3
Debtors Turnover (x)	5.9	6.7	6.3
Fixed Assets Turnover (x)	2.3	2.0	2.1
EBIDTA Margin (%)	11.9	12.3	13.8
PBDT Margin (%)	14.0	17.3	14.4
PAT Margin (%)	5.5	5.1	7.6
ROCE (%)	17.2	16.3	21.0
RONW (%)	16.3	13.7	20.1
EV/EBITDA (x)	8.4	7.3	5.1
EV/Sales (x)	0.99	0.89	0.70
Price to earnings (x)	19.2	18.8	10.6
Price to book value (x)	2.9	2.3	2.0

Research Team

Name	Sector	Tel No	E-mail id
Dipen Shah	IT, Media, Telecom	+91 22 6634 1376	dipen.shah@kotak.com
Sanjeev Zarbade	Capital Goods, Engineering	+91 22 6634 1258	sanjeev.zarbade@kotak.com
Teena Virmani	Construction, Mid Cap, Power	+91 22 6634 1237	teena.virmani@kotak.com
Awadhesh Garg	Pharmaceuticals	+91 22 6634 1406	awadhesh.garg@kotak.com
Apurva Doshi	Logistics, Textiles, Mid Cap	+91 22 6634 1366	doshi.apurva@kotak.com
Saurabh Gurnurkar	IT, Media, Telecom	+91 22 6634 1273	saurabh.gurnurkar@kotak.com
Vinay Goenka	Auto, Auto Ancillary, Sugar	+91 22 6634 1291	vinay.goenka@kotak.com
Saday Sinha	Economy, Banking	+91 22 6634 1440	saday.sinha@kotak.com
Lokendra Kumar	Oil & Gas	+91 22 6634 1540	lokendra.kumar@kotak.com
Shrikant Chouhan	Technical analyst	+91 22 6634 1439	shrikant.chouhan@kotak.com
Kaustav Ray	Editor	+91 22 6634 1223	kaustav.ray@kotak.com
K. Kathirvelu	Production	+91 22 6634 1557	k.kathirvelu@kotak.com