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Ajcon's Xpress idea: Sundram Fasteners Ltd. (SFL) - "BUY", 9th September, 2014

About the Company: Sundram Fasteners is a flagship company of TVS group. The Company is engaged in the manufacturing of automotive and engineering components. SFL has factories at Tamil Nadu, Puducherry, Andhra Pradesh and Uttarakhand. In addition, SFL through its subsidiaries has factories in China, United Kingdom and Germany. The Company has established a track record of leadership over 40 years

Product range: The product range consists of high-tensile fasteners, powder metal components, cold extruded parts, hot forged components, radiator caps, automotive pumps, gear shifters, gears and couplings, hubs and shafts, tappets and iron powder. Over the years, the Company has acquired cutting-edge technological competencies in forging, metal forming, close-tolerance machining, heat treatment, surface finishing and assembly.

Domestic Sales: Domestic sales showed a decline at Rs. 1,220 crores from Rs. 1,347 crores in the light of drop in production of vehicles, especially Medium and Heavy commercial vehicles. Demand from major automotive OEMs was muted throughout the year. Aftermarket sales declined moderately as confidence levels of dealers were low resulting in carrying lower stocks.

Exports: In FY14, the US market recovered modestly though not uniformly across all customers of the Company. European markets continued to be hit by recession and negative sentiments. Exports were at Rs 761 crores as against Rs 678 crores in the previous year, an increase of 12%. Export sales were over 38% of the overall sales revenues. During the year, the Company set up a new factory (SEZ 2) at Mahindra World City for manufacture of new variants of shafts, which commenced operations in the last quarter of the financial year. The existing SEZ unit has been further expanded. These additions have been made based on long term contracts with existing customers. The Company's push for adding new products and new customers is expected to result in further improvement in exports in the near future. Volatility in exchange rates and slow recovery in demand from European customers are causes for concern.

Financial performance: Automotive component industry leans very heavily on commercial vehicle segment for high volume sales and profits. Continuous decline in sales of commercial vehicles resulted in lower sales in many of the units of the Company. However, going ahead, revival in Commercial Vehicles industry is expected owing to pickup in Indian economy measured by GDP growth. Raw material prices were more or less steady during the year. Other input costs rose across the board, especially of petroleum based products which would reduce in FY15 due to fall in crude oil prices. Spend on wages and salaries increased as dearness allowance increased in line with the cost of living index linked to inflation. The Company continued to be under pressure due to rising manufacturing costs. Freight rates also increased in line with increase in cost of diesel and other inputs related to the transportation industry. Power availability eased considerably and measures taken by the Company over the years enabled the Company to reduce usage of self-generated power to a bare minimum and also reduce costs.

During the year, PBIDT (Profit before interest, foreign exchange fluctuation, depreciation, exceptional income and tax) was at Rs 304.84 crores as against Rs 283.63 crores in the previous year. The Company made sizable investments in creation of capacities for new products and additional capacities for manufacture of existing products to meet projected demand from domestic and international customers. These investments resulted in additional interest costs. Tight money policies followed by Reserve Bank of India resulted in steep increase in interest rates on rupee borrowings and forward premiums in respect of foreign currency borrowings. Financing costs, including premiums on forward cover and adverse foreign exchange variations of Rs 27.83 crores (Rs 40.27 crores) on foreign currency borrowings, were at Rs 58.58 crores as against Rs 81.35 crores in the previous year. The Company has been able to limit interest costs on account of a concerted action to reduce working

capital requirements across its major divisions as a result of which borrowing levels have reduced considerably. In line with the Accounting Standard AS-11 (dealing with the effects of change in foreign exchange rates) and to ensure the principles of consistency, the Company recognises the exchange differences arising out of foreign currency denominated items as expense or income in the profit and loss statements. Depreciation was higher at Rs 76.37 crores (Rs 71.62 crores). Profit before tax was higher by 30% at Rs 169.89 crores (Rs 130.67 crores). Investment Allowance admissible under Sec. 32AC of the Income Tax Act resulted in lower net tax rate. Profit after tax after providing for exceptional items increased by 27% to Rs 120.89 crores (Rs 95.06 crores).

Sundram Fasteners acquired 24.53% stake on TVS Infotech

The Company had announced that its wholly owned subsidiary, Sundaram Fasteners Investment, had acquired 24.53% of equity share capital of TVS Infotech (an existing associate company) consequent to the allotment of rights shares to Sundaram Fasteners Investment. With this acquisition, Sundaram Fasteners Investment has 62.27% equity stake in TVS Infotech. TVS Infotech has thus become a subsidiary of Sundaram Fasteners Investment and consequently a step-down subsidiary of Sundram Fasteners with effect from 18 June 2014.

Outlook and Valuation: We believe SFL is strong player in the auto ancillary segment backed by quality management. Revival in economic cycle would lead to growth in auto industry especially in commercial vehicles segment which would augur well for the Company. Recent decline in crude oil prices would lead to SFL's better margin performance in the near future. We recommend a "BUY" on the stock with a price target of Rs. 160 assuming a P/E of 25x FY15E earnings, an upside of 20%, over a period of 3 to 6 months.

Stock Holding Disclosure under SEBI regulations:

- a) **Analyst holding: No**
- b) **Company holding: Yes**
- c) **Directors holding: No**
- d) **Group/Associates Position: No**
- e) **Relationship with management: No**

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