

Dear Member,

Saral Gyan team wishes you a Happy & Prosperous New Year 2018!

We are pleased to inform you that Hidden Gem stock of Nov 2017 is released by our team today on 31 December 2017. Hidden Gem stock of November month is **Talbro Automotive Components Ltd. [BSE Code: 505160, NSE CODE: TALBROAUTO]**. Talbro Automotive Components is a small cap company with market capital of Rs. 380 crores and operates in auto ancillaries sector.

### **1. Company Background:**

Talbro Automotive Components Ltd., the flagship manufacturing company of the Group was established in the year 1956 to manufacture Automotive & Industrial Gaskets in collaboration with Coopers Payen of UK. Talbro Automotive has been in the Gaskets business for more than 60 years. Currently company manufactures Gaskets & Heat Shields, Forgings, Suspension Systems & Modules, Anti Vibration components and Hoses. It has strong partnerships formed with global giants. Over the period 2012-2016, the company roped in strategic business partners to grow the business and diversified into the allied auto components space

Talbro Automotive has three joint ventures –

- i) Nippon Leakless Talbro Pvt. Ltd (JV partner - Leakless Corporation – Japan)
  - One of the largest global manufacturers of gaskets and a major Supplier for Honda
  - Established in 2005 with 40% Talbro Share
  - 100% Sales to OEMs to Honda and Hero
- ii) Magneti Marelli Talbro Chassis Systems Pvt. Ltd. (JV partner - Magneti Marelli - Italy)
  - 50:50 partnership commenced production in April 2012
  - Significant share of Control Arms business from Maruti Suzuki and Tata
  - 100% Sales to OEMs
- iii) Talbro Marugo Rubber Pvt. Ltd. (JV partner - Marugo Rubber - Japan)
  - Global leader in supply of AntiVibration Product and Hoses
  - 50:50 partnership commenced production in February 2013
  - 100% Sales to OEMs predominantly Maruti Suzuki

### **Product Portfolio**

- i) Gaskets and Heat Shields: With more than 58 years of hands-on manufacturing experience, Talbro state-of-the-art facilities deliver more than 8000 products for complete sealing, Heat Shield and NVH Solutions (Noise, Vibration, and Harshness) to a wide range of customers. Manufacturing facilities are equipped with state-of-the-art tool rooms with technologically advanced machines from Deckel Maho (Germany), Hass (USA) and Charmelle (Switzerland). It also includes CNC machines, specialized

presses-mechanical, pneumatic and hydraulic with a capacity range of up to 500 tons, together with sophisticated surface coating equipments. Dynaseals is the brand under which company sells its gaskets and charges a premium of about 15-20% in the aftermarket.

ii) Forgings: Talbros Forging Division was established in 2006 and currently has annual installed capacity of 8500 tons with hot forging press lines ranging from 750 ton to 1600 ton. The company is equipped with heat treatment facilities including normalizing, ISO-annealing, hardening & tempering, induction hardening and in-house machining facilities with CNCs & VMCs to ensure benchmark standards. Strong product engineering capability with modeling software using Unigraphics, process simulation using deform and dedicated tool room facilities including MKINO vertical machining centers, EDMs and as well as wire cut EDM. This business is seeing a turnaround because of cheaper power now available (compared to expensive DG set and Gas based power earlier) and newer orders from domestic and global players.

iii) Suspension Systems: The company through its JV, has the capability to design, develop and manufactures Chassis components including Control Arm, Steering Knuckle, Front Cross Member, Rear Twist Beam Axle, Wheel Group and Semi Corner Module Assemblies for automotive application. The well-equipped facility with manufacturing practices compiled with APQP, FMEA, PFMEA, PokaYoke, PPAP and TPM activities showcases an advanced research, design, development and testing capability.

iv) Anti-vibration components and Hoses: The company through its JV can design, develop and manufacture products such as Suspension Bushes, Strut Mounts, Engine Mounts & Hoses. The plant is equipped with the latest technology having injection moulding, vacuum transfer injection moulding and compression moulding, kneaders, sandblasting, phosphating adhesive spray line integrated to give world class products.

## **2. Recent Developments:**

### **i) Technical Collaboration for development of New Products**

Talbros Automotive has recently entered into technical collaboration with Sanwa Packing from Japan, a company which has been engaged in the business of gaskets since 1945. Through these technical collaboration, the company is developing newer products to tap new markets.

Talbros Automotive has developed a product called Heat shields which is expected to gain traction with the stricter emission norms coming in. With the requirement of BS VI norms, entire auto industry would require this product to meet the new requirements. Heat shields are said to have overall domestic market size of about Rs.~125 - 150 crores and the company intends to sell and capture about 18-20% of said market in a span of 3 years.

Management of the company is confident to increase its revenues from this product by Rs. 25 crores by end of FY20. More importantly this product is not a replacement of gaskets and hence does not entail any impact on company's existing sales.

## **ii) Reduction of GST to 18% to Improve Domestic Sales**

During first half of FY17-18, domestic gasket aftermarket sales were impacted on account of GST implementation. Management highlighted that in 2QFY18, there was sequential improvement in performance, but was not substantial owing to anticipation of reduction of GST on gaskets. From November 2017, GST has been reduced to 18%. With GST related hick-ups behind the company, we expect domestic gasket aftermarket sales to pick-up in 2HFY18.

Owing to weak performance in first half of FY18, we expect the growth in FY18 to be low. However, robust growth is expected to resume in this segment from FY19.

## **iii) Talbros Automotive completes Partial Disinvestment of Non-Core Assets**

Talbros Automotive has successfully completed the partial disinvestment of its non-core materials business assets by sale to the Indian affiliate of Interface Performance Materials, USA who are pioneers and leaders of gasket materials worldwide.

The company has also entered into a raw material sourcing agreement with them to source various gasket raw materials from Interface's Indian manufacturing unit. The local raw material sourcing will commence in Q4 2018.

## **3. Financial Performance:**

### **Talbros Automotive consolidated net profit rises 129.8% in the Sept 2017 quarter**

Net profit of Talbros Automotive rose 129.80% to Rs 6.94 crore in the quarter ended Sept 2017 as against Rs 3.02 crore during the previous quarter ended Sept 2016. Sales rose 25.98% to Rs 100.80 crore in the quarter ended Sept 2017 as against Rs 80.01 crore during the previous quarter ended Sept 2016.

### **Talbros Automotive consolidated net profit rises 10.5% in the June 2017 quarter**

Net profit of Talbros Automotive rose 10.5% to Rs 2.73 crore in the quarter ended June 2017 as against Rs 2.47 crore during the previous quarter ended June 2016. Sales declined 4% to Rs 80 crore in the quarter ended June 2017 as against Rs 83.34 crore during the previous quarter ended June 2016.

#### **4. Key Risks & Concerns**

- i) Company supplies certain products that can become redundant with increase of electric vehicles sales which will have impact on company's existing business. However, we do not expect any significant impact over the next 2-3 years.
- ii) Volatility in price of raw materials such as copper, steel, iron, etc can adversely impact company's margins.
- iii) The company generates nearly 75% of its revenue by selling its products in domestic market. Any slowdown in automobile demand in India can impact its revenue growth.

#### **5. Saral Gyan Recommendation:**

- i) Talbros Automotive has large and diversified customer portfolio ranging from segments comprising of 2 wheelers, passenger vehicles, HCV/LCV and Agri & offloaders. The company clocks around 40% of its revenue from the top 5 Indian auto companies. With India becoming a hub for global OEMs for sourcing and manufacturing, the company is in strong position to leverage the global demand for its products and grow its market share in coming years.
- ii) Talbros Automotive revenues are not linked to single segment or single product. Gaskets, forgings and other products accounts for 67%. 19% and 14% of the company's consolidated revenues respectively. In terms of segments, two wheeler, passenger vehicle and commercial vehicle contribute 37%, 26% and 28% respectively. While domestic OEM's customer's accounts for ~75% of the revenues, other 25% comes from exports and domestic aftermarket.
- iii) Talbros Automotive supplies gaskets through the standalone entity and also through its JV with Nippon Leakless. The company is the market leader in the two-wheeler, agri/off-loaders and the commercial vehicle segment. Standalone gasket business accounts for 57% of consolidated revenues, including JV it is 67%. In the past three years, revenue CAGR in standalone gasket business has been 4%. We expect healthy growth in auto demand and company's efforts on increasing business in passenger vehicle segment and exports will lead to ~13% revenue CAGR in standalone gasket business over FY17-FY20E.
- iv) The company enjoys market leadership position in the two-wheeler and the commercial vehicle segment, however its presence in the passenger vehicle segment is negligible. With continuous increase in product offerings with JVs, the company perceives huge growth potential in this segment and thereby considers the passenger vehicle segment as key focus area for growth in the gasket business. As per management, products like post coated gasket and heat shields can help the company to achieve 10-15% market share in the passenger vehicle gasket market.
- v) Talbros Automotive has registered sales CAGR of 2.8% and profit CAGR of 45.2% with ROE of 12.9% over last 5 years. The company has reduced its debt over last

couple of years, balance sheet is expected to strengthen further as debt-equity is likely to come down from 0.8x in FY17 to 0.5x in FY20E.

vi) Heat Shield could be a big opportunity for the company over next 2 – 3 years. Incremental demand for heat shields which are being developed under a technical licensing agreement with Sanwa Packing Industry will lead to increased contribution for the company. We expect demand pick-up for heat shield to take some time and meaningful revenue from heat shield business to happen from FY20 onwards. However, the government preponing the implementation of BS VI to April 2018 for the NCR region augurs well for the demand of the heat shield portfolio.

vii) Exports account for ~21% of Talbros Automotive's standalone revenues. Majority exports happen in the standalone business of gasket and forgings. The company is taking various initiatives to grow its exports across business segments in the coming years. Various new orders (company won orders from BMW, Ducati, Kubota Japan, Caterpillar Thailand and GKM Italy) secured by the company in different business segments will drive exports growth going ahead.

viii) Forging business of the company which accounts for 19% of consolidated revenues is witnessing high growth. Talbros has added international players to its client list like BMW, Volvo, Jaguar, Eicher, GKN and Amul Industries. The company received a large order of Rs. 175 crores (spanning over 7 years) from BMW. Company also earned orders from GKM, Italy. Company is adding two more presses (700 ton and 1,000 ton) and the same is expected to be operational by January 2018. Multiple order win gives visibility to strong revenue growth in the forging business.

ix) Talbros Automotive did a partial strategic disinvestment of its non-core materials business assets and sold it to Indian affiliate of Interface Performance Materials, USA. This will enable Talbros Automotive to source materials locally, resulting in 15% reduction of imports and bring savings in operational costs.

x) As per management, the company's vision is to achieve turnover of close to Rs. 700 crores and generate EBITDA and PAT margins of 14% and 5% respectively by effectively earning a ROCE of above 20% over next 3 years. The company achieved sales of Rs.428 crores with EBITDA and PAT margins of 10.3% and 3.7% and ROCE of 14.4% in FY17.

xi) As of Sept'17, promoter's shareholding in the company is at 56.63%, promoters have not pledged any shares. The company has been increasing its stake marginally in previous years of which major increment came in Sept 2016 quarter wherein promoters increased their stake from 54.01% to 56.63%. Institution shareholding in the company is at 2.22%.

xii) As per our estimates, Talbros Automotive can deliver PAT of 16.5 crores in FY17-18 and Rs. 25.7 crores in FY18-19 with annualized EPS of Rs 13.4 and Rs. 20.8 respectively. At current price of 307.65, stock is available at forward P/E multiple of 14.8X based on FY18-19 earnings estimates. Company's valuation looks reasonable

considering strong earning visibility on account of major order wins and addition of new clients.

xiii) On equity of Rs. 12.35 crore, the estimated annualized EPS for FY18-19 works out to Rs. 20.8 and the Book Value per share is Rs. 124.5. At current market price of Rs. 307.65, stock price to book value is 2.47.

Considering improvement in EBITDA margins with increase in revenue from new products like post coating and heat shield in the gasket division, strong order book in forging business, ample capacity to cater to the growing demand with limited capex requirement in medium term, expected uptick in the contribution of the joint ventures in overall profitability of the company and reasonable valuations with healthy balance sheet, Saral Gyan team recommends **"Buy"** on **Talbro's Automotive Components Ltd** at current market price of Rs. 307.65 for target of Rs. 620 over a period of 12 to 24 months.

### **Buying Strategy:**

- 75% at current market price of 307.65
- 25% at price range of 220 - 250 (in case of correction in stock price in near term)

### **Portfolio Allocation: 3% of your equity portfolio.**

Wish you happy & safe Investing!

Regards,  
Team – Saral Gyan

### **LEGAL DISCLAIMER:**

Saral Gyan Capital Services (hereinafter referred as 'Saral Gyan') is an independent equity research Company. Use of the information herein is at one's own risk. This is not an offer to sell or solicitation to buy any securities and Saral Gyan will not be liable for any losses incurred or investment(s) made or decisions taken/or not taken based on the information provided herein. Information contained herein does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual investors. Before acting on any recommendation, investors should consider whether it is suitable for their particular circumstances and, if necessary, seek an independent professional advice. All content and information is provided on an 'As Is' basis by Saral Gyan. Information herein is believed to be reliable but Saral Gyan does not warrant its completeness or accuracy and expressly disclaims all warranties and conditions of any kind, whether express or implied. As a condition to accessing Saral Gyan content and website, you agree to our Terms and Conditions of Use. The performance data quoted represents past performance and does not guarantee future results.

### **DISCLOSURE WITH REGARDS TO OWNERSHIP AND MATERIAL CONFLICTS OF INTEREST:**

- a. 'subject company' is a company on which a buy/sell/hold view or target price is given/changed in this Research Report
- b. Neither Saral Gyan, it's Associates, Research Analyst or his/her relative have any financial interest in the subject company.
- c. Neither Saral Gyan, it's Associates, Research Analyst or his/her relative have actual/beneficial ownership of one percent or more securities of the subject company
- d. Neither Saral Gyan, it's Associates, Research Analyst or his/her relative have any other material conflict of interest at the time of publication of the research report.

### **DISCLOSURE WITH REGARDS TO RECEIPT OF COMPENSATION:**

- a. Neither Saral Gyan nor its Associates have received any compensation from the subject company in the past twelve months.
- b. Neither Saral Gyan nor its Associates have managed or co-managed public offering of securities for the subject company in the past twelve months.
- c. Neither Saral Gyan nor its Associates have received any compensation for investment banking or merchant banking or brokerage services from the subject company in the past twelve months.
- d. Neither Saral Gyan nor its Associates have received any compensation for products or services from the subject company.
- e. Neither Saral Gyan nor its Associates have received any compensation or other benefits from the subject company or third party in connection with the research report.

GENERAL DISCLOSURES:

- a. The Research Analyst has not served as an officer, director or employee of the subject company.
- b. Saral Gyan or the Research Analyst has not been engaged in market making activity for the subject company.

Definitions of Terms Used:

- a. Buy recommendation: This means that the investor could consider buying the concerned stock at current market price keeping in mind the tenure and objective of the recommendation service.
- b. Hold recommendation: This means that the investor could consider holding on to the shares of the company until further update and not buy more of the stock at current market price.
- c. Buy at lower price: This means that the investor should wait