CRISIL RESEARCH

CRISIL IER Independent Equity Research

Dynamatic Technologies Ltd

Detailed Report

Enhancing investment decisions

Explanation of CRISIL Fundamental and Valuation (CFV) matrix

The CFV Matrix (CRISIL Fundamental and Valuation Matrix) addresses the two important analysis of an investment making process – Analysis of Fundamentals (addressed through Fundamental Grade) and Analysis of Returns (Valuation Grade) The fundamental grade is assigned on a five-point scale from grade 5 (indicating Excellent fundamentals) to grade 1 (Poor fundamentals) The valuation grade is assigned on a five-point scale from grade 5 (indicating strong upside from the current market price (CMP)) to grade 1 (strong downside from the CMP).

CRISIL Fundamental Grade	Assessment	CRISIL Valuation Grade	Assessment
5/5	Excellent fundamentals	5/5	Strong upside (>25% from CMP)
4/5	Superior fundamentals	4/5	Upside (10-25% from CMP)
3/5	Good fundamentals	3/5	Align (+-10% from CMP)
2/5	Moderate fundamentals	2/5	Downside (negative 10-25% from CMP)
1/5	Poor fundamentals	1/5	Strong downside (<-25% from CMP)

About CRISIL Limited

CRISIL is a global analytical company providing ratings, research, and risk and policy advisory services. We are India's leading ratings agency. We are also the foremost provider of high-end research to the world's largest banks and leading corporations.

About CRISIL Research

CRISIL Research is India's largest independent integrated research house. We provide insights, opinion and analysis on the Indian economy, industry, capital markets and companies. We also conduct training programs to financial sector professionals on a wide array of technical issues. We are India's most credible provider of economy and industry research. Our industry research covers 86 sectors and is known for its rich insights and perspectives. Our analysis is supported by inputs from our network of more than 5,000 primary sources, including industry experts, industry associations and trade channels. We play a key role in India's fixed income markets. We are the largest provider of valuation of fixed income securities to the mutual fund, insurance and banking industries in the country. We are also the sole provider of debt and hybrid indices to India's mutual fund and life insurance industries. We pioneered independent equity research in India, and are today the country's largest independent equity research house. Our defining trait is the ability to convert information and data into expert judgements and forecasts with complete objectivity. We leverage our deep understanding of the macro-economy and our extensive sector coverage to provide unique insights on micro-macro and cross-sectoral linkages. Our talent pool comprises economists, sector experts, company analysts and information management specialists.

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Last updated: August, 2014

Analyst Disclosure

Each member of the team involved in the preparation of the grading report, hereby affirms that there exists no conflict of interest that can bias the grading recommendation of the company.

Disclaimer:

Dynamatic Technologies Ltd

Deleveraging and strong growth in aerospace to drive profitability

Fundamental Grade	**3/5 (Good fundamentals)**
Valuation Grade	**3/5 (CMP is aligned)**
Industry	**Auto Components**

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November 11, 2014

Fair Value	**₹1933**
CMP	**₹2010**

After a few challenging years (FY12-14) following the acquisition of an auto component business in Germany, which resulted in a highly leveraged balance sheet, and power and integration issues in the iron foundry in Chennai, Dynamatic Technologies Ltd (Dynamatic) is back on track. We foresee strong earnings growth driven by (i) turnaround in its auto business, (ii) strong aerospace order book, (iii) steady hydraulics business and (iv) a deleveraged balance sheet. Over the long term, we expect improvement across all the segments as capital will no longer be a constraint owing to healthy cash flows and improved balance sheet. However, weak sales visibility at its UK hydraulics plant and limited capacity at its Germany plant are key monitorables. We maintain the fundamental grade of **3/5**.

Aerospace: Strong revenue growth and profitability Q4FY15 onwards due to new orders

Recently, Dynamatic bagged a large order worth US$150 mn from Airbus to supply flap track beams (FTB) for the Airbus 330 aircraft series; it has been the sole supplier of FTB for Airbus 320 aircraft series since 2008. Currently, it has a regular order book to supply FTB for Airbus 320 series worth ₹550 mn each year for the next six-seven years. It has also received new orders worth US$54 mn and US$243 mn from Boeing and Bell Helicopters respectively. The company expects the new orders to contribute to revenues in Q4FY15. Following the visibility of orders, we expect this segment's revenues to grow at 25% CAGR over FY14-16.

Auto: The Indian division to report significant improvement in profitability

We expect the Indian auto business' profitability to improve significantly on account of: (a) rationalisation of the product mix and improvement in yield resulting in higher contribution and margins, (b) new client additions, (c) high domestic OEMs' sales growth with recovery in the macro-economy resulting in operating leverage benefits and (d) focus on exports. The German business is likely to report muted revenue growth as the plant is running at optimal utilisation. However, we are optimistic about the business in the long term (a) as the petrol turbocharger market offers ample opportunities with usage in engines increasing due to focus on fuel efficiency and emission norms and (b) due to focus on high-margin stainless steel turbochargers. We expect this segment's revenues to grow at 5% CAGR over FY14-16.

Hydraulics: The Indian division to log steady performance

The Indian business is expected to report steady performance while the UK business' performance is a monitorable. One of its main OEM's (CNH Brazil) tractor platforms, Womack military vehicle contract, and the gear pump business in Gima (France) were completed in FY14. We expect this segment's revenues to grow at 6% CAGR over FY14-16.

Leverage and profitability to improve further owing to sale of the non-core asset

The company has taken several initiatives to optimise the capital structure by: (a) reducing debt by ₹770 mn in FY14 through the sale of non-core asset, (b) equity infusion by promoters and (c) refinancing and repayment of high-cost debt. Leverage is expected to improve due to monetisation of the windmill asset by FY15-end. Net debt-equity is expected to improve from 4.3x in FY14 to 1.3x in FY16. The company expects to reduce its debt by half to ₹3 bn by FY17. Hence, profitability is expected to improve due to reduced interest burden.

Risks: Exposed to cyclicality of end-user industries and clients' procurement plan

(a) Auto component and hydraulic businesses are exposed to the cyclicality of the end-user industries and (b) aerospace order flows are dependent on the clients' procurement plan.

Revenue growth to remain healthy; fair value revised to ₹1,933 per share

Revenues are estimated to grow at a CAGR of 8.3% to ₹18.6 bn during FY14-16. Net profit is expected to increase to ₹911 mn in FY16 from ₹36 mn in FY14. Following the visibility of aerospace orders, expected operating leverage in the Indian auto business and lower risk on account of a de-leveraged balance sheet, we have raised our DCF-based fair value to ₹1,933 per share. At the CMP of ₹2,010, our valuation grade is **3/5.**

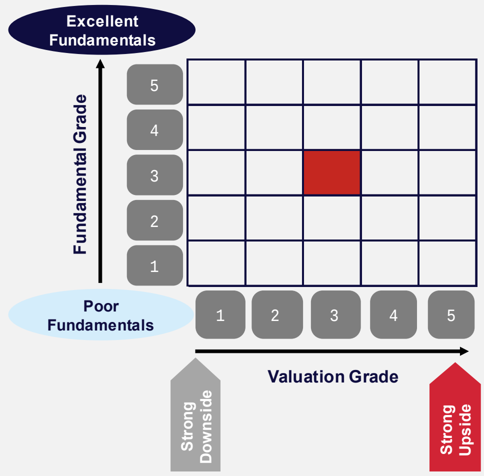
KEY FORECAST (CONSOLIDATED)

(₹ mn)	FY12	FY13	FY14	FY15E	FY16E
Operating income	15,103	14,542	15,900	16,738	18,639
EBITDA	1,441	1,405	1,680	1,797	2,269
Adj net income	194	-147	36	443	911
Adj EPS (₹)	35.9	(27.1)	6.4	69.9	143.6
EPS growth (%)	(13.0)	NM	NM	987.3	105.5
Dividend yield (%)	1.0	-	-	0.1	0.2
RoCE (%)	14.4	10.8	14.7	17.6	23.9
RoE (%)	11.9	(9.6)	2.7	20.4	26.5
PE (x)	22.3	NM	NM	28.8	14.0
P/BV (x)	2.5	2.7	8.3	4.2	3.3
EV/EBITDA (x)	7.9	7.2	10.0	9.0	7.1

NM: Not meaningful; CMP: Current market price

Source: Company, CRISIL Research estimates

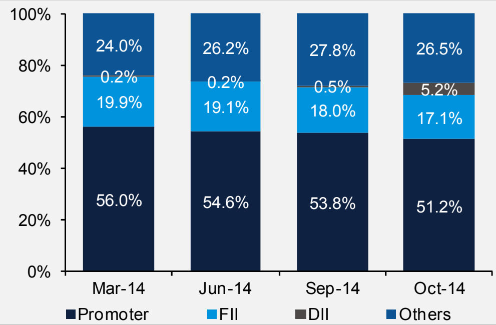
CFV MATRIX



KEY STOCK STATISTICS

NIFTY/SENSEX	8344/27875
NSE/BSE ticker	DYNAMATECH/ DYNAMATE
Face value (₹ per share)	10
Shares outstanding (mn)	6.3
Market cap (₹ mn)/(US$ mn)	12,746/207
Enterprise value (₹ mn)/(US$ mn)	16,128/262
52-week range (₹)/(H/L)	2,515/493
Beta	0.9
Free float (%)	50%
Avg daily volumes (30-days)	3,263
Avg daily value (30-days) (₹ mn)	6.9

SHAREHOLDING PATTERN



PERFORMANCE VIS-À-VIS MARKET

	Returns			
	1-m	3-m	6-m	12-m
Dynamatic	-15%	20%	140%	264%
CNX 500	6%	11%	25%	42%

ANALYTICAL CONTACT

Mohit Modi (Director) mohit.modi@crisil.com
Ankit Kedia ankit.kedia@crisil.com
Bhaskar Bukrediwala bhaskar.bukrediwala@crisil.com

Client servicing desk

+91 22 3342 3561 clientservicing@crisil.com

For detailed initiating coverage report please visit: www.ier.co.in

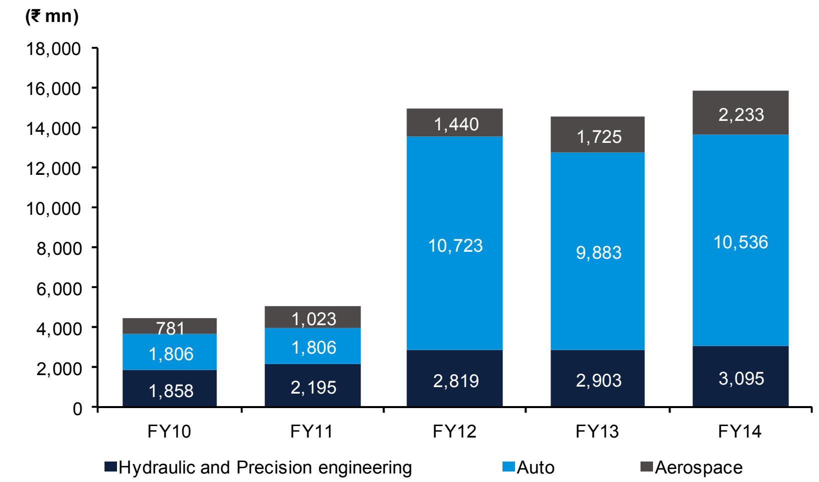
CRISIL Independent Equity Research reports are also available on Bloomberg (CRI <go>) and Thomson Reuters.

Table 1: Dynamatic - business environment

	Automotive components		Aerospace		Hydraulics	
Product / Segment	India	Germany	India	The UK	India	The UK
Revenue contribution (FY14)	10%	56%	6%	8%	11%	9%
Revenue contribution (FY16E)	12%	50%	11%	8%	11%	8%
EBITDA contribution (FY14)	-1%	34%	27%	14%	18%	6%
EBITDA Contribution (FY16E)	16%	25%	28%	15%	13%	5%
Products	Ferrous and non-ferrous castings and components such as brake systems, exhaust manifold, turbochargers, engine, transmission and chassis parts		Airframe structures such as FTB for Airbus 320 and 330 series and power cabinets to Boeing		Hydraulic gear pumps, hydraulic valves, cast iron body pumps, combined displacement pump packages, fan drive systems and fixed displacement pumps	
Manufacturing facility	Chennai, India and Schwarzenberg, Germany		Bengaluru, India; Bristol and Swindon, the UK		Bengaluru, India and Swindon, the UK	
Key customers	Hyundai, Tata Motors, Volkswagen, BMW, Daimler, Ford, Nissan, Audi, etc.		Airbus, Boeing, Bell Helicopters, Spirit Aerosystems, GKN Aerospace, etc.		Mahindra & Mahindra, John Deere, Cummins, Eicher, Escorts, Caterpillar, etc.	
Market position	Single source supplier to Hyundai India Ltd for specific engine components		Single source supplier to Airbus for flap track beams for A320 and A330 aircraft. Tier 1 supplier to global OEMs such as Boeing and Bell Helicopters		Caters to all tractor manufacturers in India. Has 64-65% share of the domestic tractor market	
Industry growth expectations	Domestic auto component production to reach ₹4,000 bn by FY19 at five-year CAGR of 14-16%		Orders are expected to flow to Indian manufacturers due to their cost competitiveness		Tractor demand is expected to grow at 8-10% CAGR over the next five years	
Demand drivers	Strong growth in vehicle production (14-16% CAGR in value terms)				■ Increase in farm incomes and focus on higher productivity to increase the demand for agriculture equipment including tractors ■ Increasing non-farm usage of tractors	
Sales growth (FY12-FY14 – 2-yr CAGR)	-18%	4%	33%	21%	-5%	20%
Sales forecast (FY14-FY16E – 2-yr CAGR)	15%	2%	47%	6%	12%	0%

Source: Company, CRISIL Research

Figure 1: Segment-wise revenue contribution over the past five years



Source: Company, CRISIL Research

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Grading Rationale

Consolidation and deleveraged balance sheet = benefit…

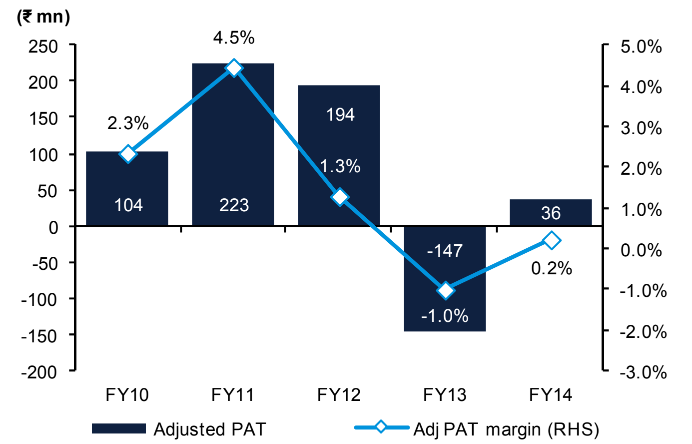
Driven by overseas acquisitions in each of the three segments (auto, hydraulic and aerospace), Dynamatic has diversified and grown manifold over FY07-14 – sales growth up six times and asset base up five times. However, adjusted PAT reported -20% CAGR over the same period. Two (hydraulic division of Sauer-Danfoss, the UK and Eisenwerk Erla, Germany) of the three acquisitions, which were funded largely through debt, have pushed the gearing of the company to alarming levels. Further, losses in the Indian auto component business (due to the power crisis in Chennai, integration issues and rupee depreciation), sluggish demand in the UK hydraulic market and higher interest outgo deteriorated the company's earnings during FY07-14.

Dynamatic's debt increased significantly following the €26.4 mn (about ₹1,700 mn) debt-funded acquisition of Eisenwerk Erla, Germany in FY12. The decline in operational profitability worsened the situation. The net debt/equity and interest coverage ratio deteriorated to 4.1x and 1.4x in FY12 and further to 4.9x and 1.1x in FY13, respectively, as the company's EBIT margin declined to 6.4% and it reported a loss of ₹119 mn in FY13. However, over the past 15 months, the management has been focussing on consolidation, cost optimisation and capital structure optimisation by deleveraging the balance sheet through equity infusion and sale of non-core assets. The company has also taken steps to address the operational issues, especially in the auto component business in Chennai. The strategy is now paying off; the net debt/equity improved to 4.3x in FY14.

Dynamatic is well positioned for growth and we expect earnings to grow considerably driven by an improvement in profitability of the auto business, healthy order book for the high-margin aerospace segment and lower interest payout as the balance sheet gets deleveraged. Further, considering the company's established position, marquee clientele across segments, full integration of its overseas acquisitions and expected healthy profitability, its long-term prospects appear promising.

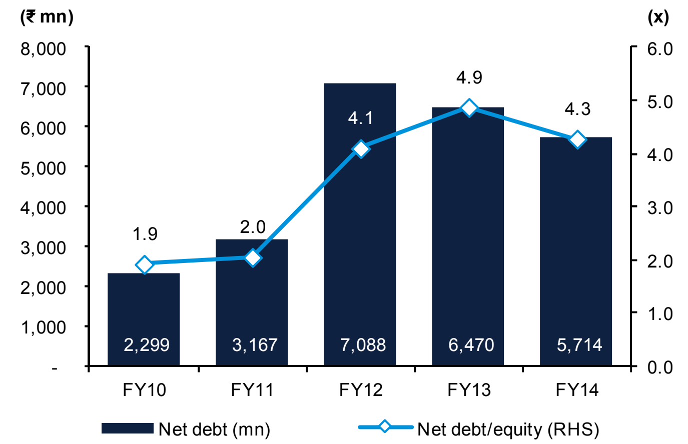
Focus on cost optimisation, exports and customer diversification will help to improve profitability

Figure 2: PAT and PAT margin improved marginally in FY14



Source: Company, CRISIL Research

Figure 3: Net debt and gearing ratio improved



Source: Company, CRISIL Research

… of lower interest cost, thereby enhancing profitability

Asset-light strategy to improve return ratios and increase operational competitiveness

In the past 12-18 months, the management has worked aggressively to optimise capital structure through strategic initiatives such as monetisation of non-core assets, rationalisation of cost of funds and equity infusion to deleverage its stretched balance sheet. In FY14, the company received ₹285 mn from the sale of its land in Chennai and the promoter group has infused ₹200 mn through warrant conversion. It has used the proceeds to fully retire its high-cost Kohlberg Kravis Roberts (KKR) debt. All this has resulted in significant improvement in the balance sheet with decrease in debt-equity from 5.3x in FY13 to 4.6x in FY14.

In Q1FY15, it sold and leased back (lease rate of 12%) for eight years a 5.2-acre factory in Peenya (Bengaluru) which was used for aerospace, for ₹700 mn. The company further plans to monetise its windmill asset (near Coimbatore) to reduce debt. It expects to reduce debt by more than ₹1,000 mn using the proceeds from the sale of the Peenya factory and windmill in FY15. We have assumed a debt reduction of ₹1,545 mn in FY15.

Recently, long-term and short-term ratings for the captioned line of credit were enhanced from BB+ and A4+ to BBB- and A3, respectively, by ICRA

Dynamatic has also refinanced a €18 mn loan at the German operations. It has not done hedging for this loan as repayment outflows is expected to be taken care by cash generated from German operations resulting in reduction in cost of debt from 6.8% to 3.8%. With the repayment of the high-cost KKR debt, in the beginning of Q1FY15, Dynamatic reduced the overall cost of debt (on rupee loan) to 15% from 20%-plus in Q1FY14, which is further expected to reduce due to a better credit rating. We expect profitability to improve on account of lower interest burden resulting from improved capital structure. Overall, with the expected improvement in profitability, we expect the company's net debt/equity to improve to 1.6x in FY15 and 1.2x in FY16.

Snapshot of the non-core asset for sale in FY15

Dynamatic expects to get ₹700 mn from the sale of the 12 MW windmill near Coimbatore.

- **Windmill**: Dynamatic plans to sell its windmill, which was bought for ₹320 mn in FY09 (under the captive group scheme of Tamil Nadu Electricity Board), to support its aluminium foundry in Chennai. However, the state government's commitment for uninterrupted power supply makes the windmill redundant. Though the PLF of wind farms is low at 12%, the 440-acre freehold agriculture land near Coimbatore airport along with all approvals and the evacuation facility in place makes it attractive from the point of replacement and expansion of wind capacity. We expect the company to garner ₹500 mn in FY15 from the sale.

Aerospace: Robust order book to drive growth

Leveraging its experience with Hindustan Aeronautical Ltd (HAL), Defence Research and Development Organisation (DRDO) and Airbus, Dynamatic has roped in marquee clients – Boeing and Bell Helicopters. However, growth depends on the procurement plans of the clients.

We believe the company has achieved a competitive edge based on its proven track record in servicing big names such as Airbus, Boeing and Bell Helicopters, and the capability to manufacture and assemble high precision aero structures. We believe this enables the company to grow by increasing the offerings to its existing customers and by adding more clients.

Competition in this space is expected to be limited due to strict quality controls and, hence, players restrict themselves to a few dependable vendors.

Airbus to continue as a revenue base

As per the contract with Spirit, Dynamatic will continue to supply FTB until FY20. The management has indicated that Airbus requires 45-50 FTB sets per month; this generates ₹480-550 mn in revenues per year (~₹0.9 mn per FTB set). One set contains six FTB. We believe the company would be able to renew the contract after FY15 because of a) Dynamatic's quality and timely delivery, and b) to develop a new vendor, the client will have to go through the same process of setting up a factory and training manpower. As on July 31, 2014, Airbus has pending orders of 3,352 aircraft for its A320 single-aisle jetliner. The pending order book of Airbus 320 series can generate ₹3,017 mn revenues for Dynamatic.

Recently, Dynamatic bagged a large order worth US$150 mn from Airbus for being the sole supplier for FTB for Airbus 330 series of aircraft. Delivery for this order is expected to commence in Q4FY15.

Synergy from the UK acquisition

The UK facility manufactures the machined components of FTB and other aeronautical structures for Spirit which, in turn, supplies the FTB-related components to the Bengaluru-based facility for the assembly. Going ahead, the company will continue to focus on multi-axis high speed long bed machining by leveraging the capabilities of its UK facility.

The UK acquisition was successful as it had generated ₹2,352 mn EBITDA during FY09-14, which is more than the acquisition cost

Strong order book to fuel revenue growth, profitability Q4FY15 onwards

Currently, it has regular order book to supply FTB for Airbus 320 series worth ₹550 mn each year for the next six-seven years. The company expects new orders to start contributing to revenues from Q4FY15. Following the visibility of orders, we expect this segment's contribution to revenues to improve from 14% in FY14 to 19% in FY16, implying a CAGR of 25% over FY14-16. This segment is expected to drive growth in operating profit as it enjoys high EBITDA margin compared with other two segments. Owing to the terms of the contract, the company will continue to post high margins until FY17. We expect margins from Indian operations to come down as the proportion of low-margin new orders compared with the existing orders increases but it will remain higher than the other two segments.

Robust order book of ₹30 bn to be executed over the next six years

Recently, Bell Helicopter signed a MoU with the company to explore the possibility of establishing it as a single source supplier for Bell 407 air frame cabin assembly and air frame component. As per the management, the final contract is likely to generate business of US$243 mn over the next 10 years starting from FY16. The company has already started the work on this project. It has completed the first article inspection of detail parts for the Aft Fuselage of the Bell 407 and has commenced production at five sets per month.

The Airbus' FTB project has given an entry to Dynamatic in the high precision assembly market. We expect the company will leverage its experience with its marquee clientele to add new clients. It is also trying to increase its offering to the existing clients – currently, it supplies cabinets, albeit in small quantities, to Boeing. It has received its largest order from Boeing worth US$54 mn to manufacture Ramp/Pylon parts of Chinook CH-47, further enhancing its relationship with Boeing. It has already commenced the trial production of detail parts for the Aft Pylon and Cargo Ramp assemblies for Chinook CH-47 and expects to commence delivery in Q4FY15.

Table 2: New clients' order book

	Order type	Nos.	Order book (US$ mn)	Current status
Boeing	Cabinets to store critical power and mission equipment for the P-8I patrol aircraft	44	18	In production
Boeing	Ramp and Pylon assembly of Chinook Helicopters over the next five years	100	54	First delivery is scheduled for January 2015
Bell	Aft Cabin assembly for 407 series of Helicopters	-	243	First articles for over 80 parts have been completed and it is now set to progressively build 60 aircraft sets each year beginning FY16 for the next 10 years

Source: Company, CRISIL Research

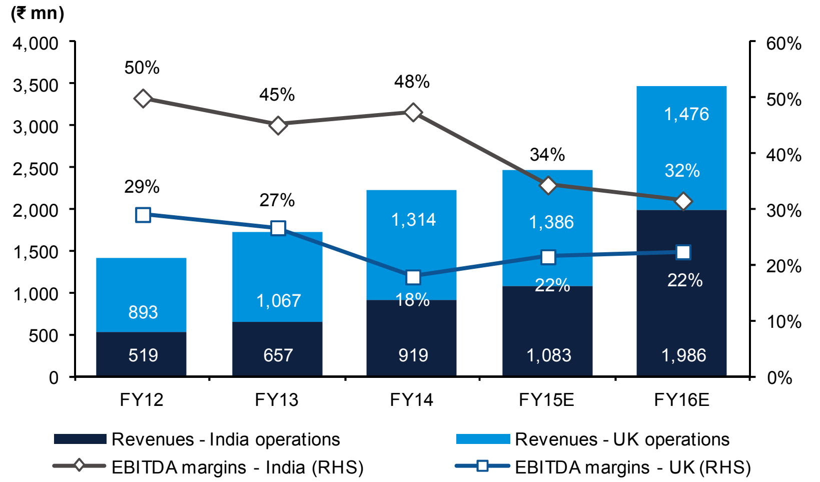
Further, the company has started the expansion of its Indian aerospace manufacturing facilities by re-appropriating the spare capacity made available by the decentralisation and relocation of its hydraulics business. It also expanded the aerospace operations at its Swindon hydraulics site to support its robust aerospace order book.

Segment enjoys superior profitability

Aerospace is a high-margin segment

The aerospace segment enjoys an average 30% EBITDA margin (48% - India and 18% - the UK). As per the management, manufacturing in India is still more cost effective than the UK. The asset light (assembly job) model and lean working capital along with high margins help the company to generate superior returns on equity. For the existing FTB orders, the components are supplied by the client – Spirit, and Dynamatic supplies back the assembled FTB; hence, it does not face raw material supply risk. Also, it supplies the assembled part on a monthly basis and receives the payment immediately after the delivery (it charges ₹0.9 mn for the assembly of one FTB set). In FY14, this segment reported RoCE of 26.5%.

Figure 4: Aerospace segment continues to enjoy healthy margins



Source: Company, CRISIL Research

Offset clause to provide extra revenues but no medium-term visibility

Dynamatic registered itself under the offset clause (companies receiving a defence-related contract have to reinvest nearly 30% of the contract in India) in April 2010. It has signed agreements for offset partnership in India with clients such as Boeing, Lockheed Martin and Northrop Grumman. Since the introduction of the offset clause, the Ministry of Defence (MoD) has concluded 16 offset contracts worth ₹4.3 bn with various vendors. As per the company, offset business worth ₹24 bn is expected to flow into the sectors of defence, civil aerospace and internal security over the next decade.

However, in the past five years, Dynamatic has received orders worth ₹61.7 mn under the offset clause. We do not expect the offset clause to benefit Dynamatic in the next two years. However, if more orders come to India, Dynamatic stands to benefit owing to its track record of servicing clients such as Airbus, Boeing and Bell Helicopters.

Prestigious Indian defence projects to enhance experience

Dynamatic has worked on many prestigious projects such as the Arjun Battle Tank, Sukhoi fighter plane, Lakshya – India's pilotless target aircraft, and the HJT-36 intermediate jet trainer. Currently, it is executing routine orders of air frame structures for HAL from its factory inside the HAL premises in Nasik. In FY14, it executed orders worth ₹57 mn.

Homeland security – has potential to contribute significantly to growth

Dynamatic has forged partnerships with leading global security technology companies such as: (a) AeroVironment Inc., US (a world leader in unmanned aircraft systems) for Unmanned Aerial Vehicles (UAV); (b) EL-GO Team, Israel (a world leader in cutting-edge, anti-terror security and access control systems) for crash rated bollards and barriers, spike systems/tyre killers, road blocks and turnstiles; (c) Erreka, Spain for restricted entry products and solutions including electro-mechanical/electro-hydraulic traffic barriers and accessories, automation systems for gates, doors, garage doors and shutters; and (d) Gatekeeper Inc. for under vehicle scanners. Through these partnerships, the company aims to offer potential customers such as the MoD, Ministry of Home Affairs, etc. solutions relating to access control, visual intelligence, counter-terror mechanisms, specialised communications, armour, bomb-disposal, command centers, and training to enhance their abilities to prepare and plan for emergencies as well as boost their response and recovery skills.

The Rakshak is a four-wheel drive vehicle specially built for deployment on any kind of terrain and is equipped with a sophisticated surveillance system

Rakshak is a unique Mobile Surveillance Vehicle (MSV) developed for India's security forces, capable of monitoring infiltration on the borders, as well as providing real-time visual intelligence within cities. The company highlighted that field trials and validation have been completed; Rakshak has attracted a lot of enquiries from various government as well as private agencies.

Recent homeland security order wins and prospective orders

In FY14, the company won a contract for five Mobile Command and Control Vehicles (MCCVs) from the State Ministry of Home Affairs. This MCCV (Prahiri) is custom-designed for surveillance in urban areas by the law enforcement agencies. It has also responded to the requirement of mini UAVs from the artillery wing of the Indian armed forces and to a global tender for mini UAVs from Central Reserve Police Force (CPRF).

In FY14, this division contributed only ₹23.2 mn to overall aerospace revenues of ₹2,233 mn (1% of aerospace total revenue). We expect this division to contribute significantly over the long term as the demand for UAVs, MSVs and MCCVs is growing in India.

New advanced aerospace facility bodes well

Over the long term, Dynamatic plans to shift its aerospace operations from Peenya, Bengaluru to a place in proximity to the planned aero SEZ (near the Bengaluru airport) where the company brought 27.5 acres land. It is expected to start construction for the new facility in the next two-three years. This will provide easy access to its prospective clients and will also help in developing capabilities in large aero-structural assemblies, composites and complex engineering which requires large space.

Auto: Indian business to witness significant improvement in profitability; German business has good long-term potential

The auto segment's EBITDA margin is likely to improve by 276 bps to 8.0% in FY16

Over the past two years, the company's domestic auto segment has been struggling with profitability due to sub-optimal utilisation of the installed capacities (attributed to disruption in power-related issues, commissioning of a new line at the iron foundry and inflationary pressures due to rupee depreciation), which resulted in increased dependence on imports leading to lower margins. The profitability of this segment is key to improve the overall EBITDA margin, being the largest revenue contributor (66% of total revenues in FY14).

The profitability of Dynamatic's Indian auto component business is likely to improve considerably as the management has addressed the key reasons that led to the deterioration. Over the past 15 months, the company has taken various measures to improve its profitability such as: (a) rationalisation of its product mix by focusing on improving the yield, (b) new client additions and (c) focus on exports.

The segment's revenues are expected to grow at a CAGR of 5% over the next two years (FY14-16) driven by expected recovery in the Indian automotive industry, client diversification and growing demand for turbochargers. However, higher growth in the Indian auto division will be offset somewhat by muted revenue growth for the German business as the plant is running at optimal utilisation. Nonetheless, we are optimistic on the German business: (a) as the petrol turbocharger market offers ample opportunities with usage in engines increasing due to focus on fuel efficiency and emission norms and (b) focus on high-margin stainless steel turbochargers.

Auto business - healthy growth over the long term

We expect the Indian auto division's profitability to improve significantly as the expected recovery in the macro-economic environment would lead to higher growth in the domestic automobile market. Unlike most of the players, Dynamatic is able to consistently deliver to OEMs in volume terms as it has facilities ranging from a foundry with a dedicated feeder line to machining, which provides it an edge against its competitors. The German business earns stable 5-7% EBITDA margin. The management has not planned any capital expansion except one-two foundry lines in Chennai as it is currently focussing on consolidation and improving profitability.

India: Profitability to recover on account of operational changes; healthy growth in the long term

The Indian auto division (including aluminium foundry) produces high quality ferrous and non-ferrous engine critical components such as intake manifold, exhaust manifold, fork shift assemblies and water pumps used for engine cooling for clients such as Global Automotive OEMs, Hyundai Motor, TATA Motors, Honeywell, Ford India, Daimler India, Nissan India, Mando India and Sundram Fasteners. EBITDA margin of the Indian auto business is expected to improve to 16% in FY16 from negative 1% in FY14.

Iron foundry to turn profitable at the EBITDA level

In FY14, Dynamatic undertook an extensive exercise to identify loss-making products using the contribution per tonne of liquid metal for each product as the profitability criteria. Accordingly, the company has improved the yield on 45 products by over 100% using proper metallurgical concepts and tooling, and stopped taking orders for 25 products which failed to meet its profitability criteria. The lost business is expected to be offset by higher profitable business from exports to new clients such as BMW, Mercedes-Benz, etc. and the in-house machining of Daimler India parts.

Table 3: Financial snapshot of iron foundry

	FY12	FY13	FY14	FY15E	FY16E
Sales (₹ mn)	784	984	1,104	1,435	1,579
EBITDA margins	-2%	-9%	-2%	8%	11%

Source: Company, CRISIL Research

Plans to move high iron castings business from Eisenwerk Erla to the iron foundry

Over the next couple of years, Dynamatic plans to move the ₹1,000-1,500 mn high iron castings business from Eisenwerk Erla, Germany to its iron foundry in Chennai as Eisenwerk Erla plans to focus on stainless steel turbochargers. The capex requirement for iron foundry to cater to the additional business is expected to be ₹200-300 mn as basic infrastructure is ready and casting machines will be shifted from Germany to the iron foundry which will increase its existing annual capacity of 23,000 tonnes by 20-25%. With the commissioning of the additional capacity, the company is targeting revenues of ₹200 mn per month. According to the management, the German foundry will focus only on high precision manufacturing in Germany while orders for low precision manufacturing will be executed in the Indian facility.

We expect the iron foundry's revenues and margins to improve due to discontinuation of the supply of loss-making products, increase in business from new clients and ramp-up in exports of high-value iron castings through Eisenwerk Erla.

Rationalisation of the product portfolio

Earlier, Dynamatic manufactured and supplied multiple products to Hyundai and other customers even if the product was not able to generate minimum contribution required to break even. In FY14, the company surrendered back to the customer all such products and also ensured a smooth transition to the new suppliers without any line stoppage at the customer's end.

Diversification of the customer base gathers momentum

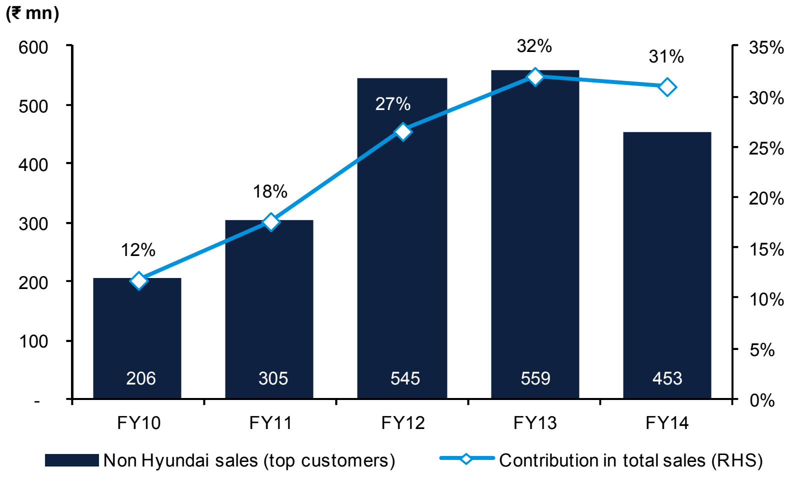
The management has been focussing on diversifying the Indian auto component segment's customer base. In the past few years, contribution from new clients such as Honeywell, Cummins and TATA Motors has increased consistently. In FY14, the company also commenced exports of exhaust manifold castings to BMW and Daimler, Germany; Lanchester housings to Mercedes-Benz; and fork shift assemblies to Getrag Ford, Europe.

First Indian foundry to be approved by BMW, Germany for exhaust manifolds. Currently, it supplies 5,000 manifolds per month to BMW

In FY14, the Indian auto business posted 16% decline in sales in line with the industry; however, the share of revenues from new clients increased from 27% in FY12 to 31% in FY14.

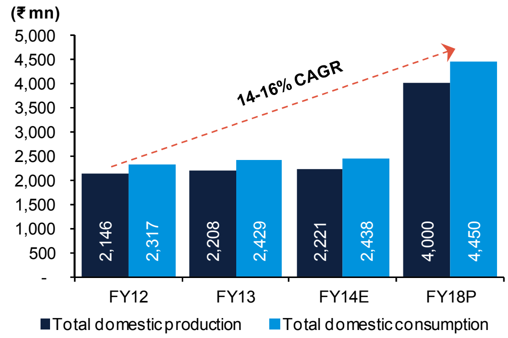
With the increasing contribution from new clients, we expect Hyundai's contribution to decrease going ahead (currently derives close to 41% of revenues - 4.4% of consolidated revenues from sales to Hyundai). The diversified client base is expected to provide a steady revenue stream and help the company to ride the long-term industry-wide growth.

Figure 5: Increasing revenue contribution from new clients



Source: Company, CRISIL Research

Figure 6: Strong 14-16% growth over the next five years



Source: Industry, CRISIL Research

Strong long-term demand outlook; 11-14% CAGR over FY14-19

CRISIL Research expects auto component production to grow at a CAGR of 11-14% during FY14-19 to be driven by better OEM demand and increasing exports. CRISIL Research expects domestic auto component production to reach ₹4,000 bn by FY19 at a five-year CAGR of 14-16%, driven by a strong growth in vehicle production. Growth will be led by the cars, utility vehicle and commercial vehicle segments, which will together constitute 75-77% of the total OEM demand. Exports are expected to grow at a CAGR of 18-20% during the same period.

Germany: Increasing demand for petrol turbochargers will benefit the company

One of the few global foundries capable of manufacturing petrol turbocharger housings

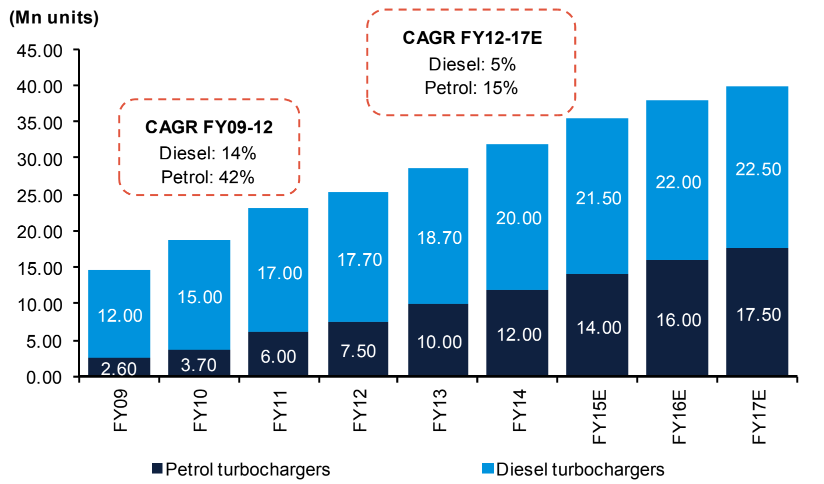
Eisenwerk Erla manufactures and machines intricate ferrous castings for turbochargers and exhaust manifolds, for both petrol and diesel engines. As turbochargers increase the fuel efficiency of the engine and decrease carbon emissions, increased focus on fuel efficiency and environmental safety bodes well for the turbocharger market. Further, Eisenwerk Erla's focus on the highly underpenetrated petrol turbocharger market (contributes 90% to its total turbochargers revenues), existing global clientele and capability to manufacture superior castings place it well to benefit from the growing demand for turbochargers.

Focus on highly underpenetrated petrol turbocharger market to pay off

Eisenwerk Erla's focus on the highly underpenetrated petrol turbocharger market enables it to cater to this fast growing segment of the turbocharger industry. Petrol turbocharger volume sales grew at a CAGR of 42% over FY09-12 compared with 14% growth in diesel turbochargers over the same period. Further, it is expected to grow at 15% CAGR compared with diesel turbochargers' 5% growth over the next five years.

Turbochargers are used in diesel engines to compensate for lower horse power of diesel engines vis-a-vis petrol engines. However, their usage in petrol engines is likely to increase with the rising focus on fuel efficiency and emission norms. In diesel engines, the penetration of turbocharger is estimated to be as high as 80-90%, while it is very low (estimated to be 15-18%) for petrol engines. However, the company has been able to increasingly penetrate the petrol engine market – the number of manufactured units is up from 2.5 mn in FY09 to 7.5 mn in FY12.

Figure 7: Petrol turbocharger to lead the growth



Source: Industry, CRISIL Research

Healthy long-term prospects for turbochargers

The global automotive turbocharger market, in terms of value, is projected to grow at a CAGR of 10.12% over 2014-19. In 2014, the turbocharger market is estimated to be dominated by Europe with a value share of 44.3% followed by Asia-Oceania with 35.8%. The North American market is estimated to have a market share (value) of 15.8% in 2014.

In terms of volumes, it is projected to reach 49.1 mn units by 2019 at a CAGR of 9.14% over 2014-19. In 2013, it is estimated that Europe accounted for nearly 44.9% of the turbocharger market in terms of volumes followed by Asia-Oceania and North America, which bodes well for Eisenwerk Erla in the long run.

Capacity constraint will cap growth in the short term

Eisenwerk Erla is running at optimal capacity utilisation. The management does not plan to increase the capacity in the near term; we believe this is because of the stretched balance sheet. Further, the management has indicated that it is in the process of developing steel casting (explained in the next paragraph) and is likely to expand that capacity to diversify its product portfolio. We expect higher revenue growth in FY17 to be driven by the expected capacity addition for steel turbochargers.

Focus on steel casting to drive growth in the long run

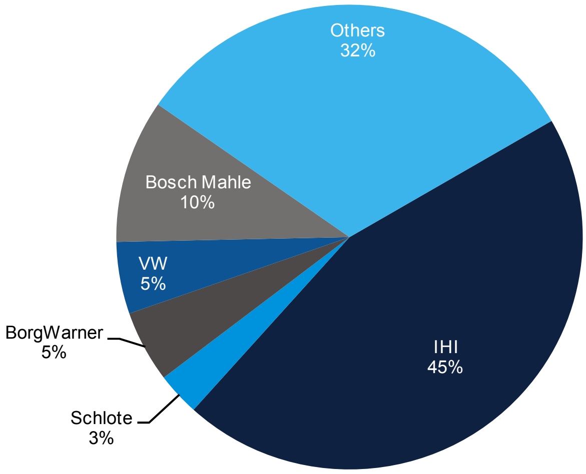
Dynamatic has already started working on the development of steel casting for petrol turbochargers. Engine downsizing and change in the burning process to increase fuel efficiency have increased the temperature of petrol engines. A high nickel iron casting (D5S) can withstand temperatures up to 950 degree Celsius but steel castings are required to withstand temperature higher than that. As per the management, a steel turbocharger can withstand temperature up to 1050 degree Celsius. According to the management, there are very few foundries that have started work in this direction.

In FY14, the company successfully completed three stainless steel turbochargers prototype projects for Audi, Daimler and Mitsubishi. The management is optimistic about the growth potential of stainless steel casting for turbochargers going ahead.

Strong relationship with leading global companies will help to grow steel casting

Globally, turbocharger manufacturing is dominated by a few players such as Honeywell, Borg Warner, IHI Corporation, Cummins, Continental and MHI (Mitsubishi Heavy Industries). Eisenwerk Erla supplies housings to IHI and Borg Warner. BMW, Bosch Mahle, Schlote and Volkswagen (tier I suppliers) are also part of its client list. In FY14, it also commenced main turbine housing projects for the Volkswagen engines.

Figure 8: Revenue-wise client mix in FY14



Source: Company, CRISIL Research

Hydraulics: Indian business to register steady performance; the UK business to be a drag

Over the next two years, the Indian hydraulics business is expected to grow at a rate higher than the industry driven by (a) its established position (64-65% market share) in the Indian tractor industry, (b) renewed focus on the replacement market (supported by its well-known brand name), (c) launch of new products such as 'Indra' pump (a next generation pump, 45% lighter and highly cost-efficient) and (d) renewed management focus on this segment to enhance its competitive edge by restructuring its Indian operations. Dynamatic has been the market leader for a long time which gives it a competitive advantage over new players and makes it difficult for new players to gain an entry. Bosch, the second largest player, has 20-25% market share.

Successful restructuring of Indian operations to improve its competitiveness

In FY14, the company successfully completed the decentralisation of its Indian hydraulics operations and transfer of operations from Peenya, Bengaluru to the new locations in a nearby vicinity with minimal impact on production. With this, the company transformed a large manufacturing hydraulics facility in Peenya, Bengaluru into a networked group of three leaner industrial units where each unit caters to the market demand for specific products. Following its asset-light strategy, the company has leased all three units on a long-term basis to minimise investment in fixed capital.

Table 4: Financial snapshot

	FY12	FY13	FY14	FY15E	FY16E
Sales (₹ mn)					
India	1,856	1,619	1,681	1,869	2,095
The UK	981	1,284	1,414	1,336	1,410
EBITDA margins					
India	20%	17%	18%	13%	14%
The UK	1%	1%	7%	7%	7%

Source: Company, CRISIL Research

The hydraulics segment is expected to grow at 6.3% CAGR over the next two years (FY14-16), mainly driven by the Indian business. We expect this segment's contribution to revenues to remain at 19% in FY16, same as in FY14. The profitability of the segment is likely to remain subdued as the UK business is expected to face challenges on the revenue front; the UK business' performance is a monitorable.

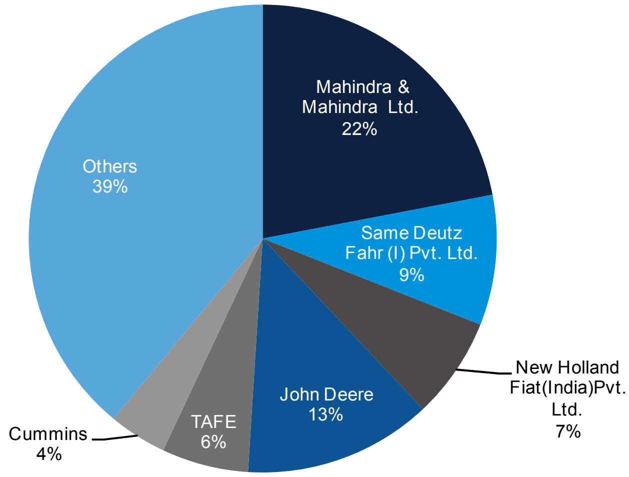
Domestic business continues to enjoy growth and profitability

Dynamatic enjoys a leading position in the domestic hydraulics gear pump industry. It has been selling hydraulic pumps for more than two decades and, thus, enjoys the first-mover advantage. We expect its Indian hydraulics business to grow faster than the industry driven by:

Established relationship with all tractor manufacturers: Dynamatic's dominant presence in the tractor manufacturing market will help it to grow with the industry. It enjoys 64-65% market share in India; it sold 0.45 mn hydraulic gear pumps to OEMs in FY14 compared with the total requirement of around 0.69 mn hydraulic gear pumps (assuming one pump per tractor). It is a key supplier to the largest domestic tractor manufacturer – Mahindra and Mahindra (supplies 70% of its total requirement). It sells to all the top six tractor manufacturers in India. Its nearest competitor is Bosch, which, as per the management, supplies the remaining 30% to Mahindra and Mahindra.

The management highlighted that the potential for tandem pumps is huge in India (12,000-13,000 pumps) as demand from OEMs is increasing and expects its production of tandem pumps to grow at 15-20% over the next two years (Dynamatic currently produces 1,000-1,200 pumps). The management also highlighted that it has an edge over Bosch in tandem and Indra pumps. We expect the company to benefit from the expected pick-up in demand from the domestic construction and infrastructure industries, expected recovery in the automotive industry and expected higher demand for tandem pumps due to increasing trend towards power steering in tractors due to rising farm incomes and focus on higher productivity.

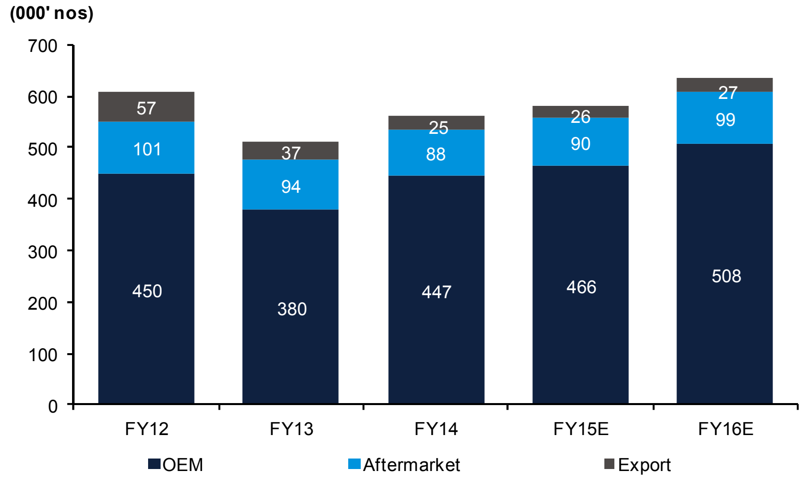
Figure 9: Client-wise contribution to FY14 revenues



Source: Company, CRISIL Research

Focus on the replacement market: Dynamatic is now targeting to increase its penetration of the replacement market (contributed 16% to FY14 hydraulic gear pump sales), which is largely catered to by unorganised players. This will not only diversify its revenue stream but will also drive sales and profitability as realisations are higher than the sale to OEMs. Hydraulic gear pumps have a life of about 8-10 years while tractors are used for about 15-17 years, which ensures a steady replacement market. Over the years, Dynamatic has created a brand in the hydraulic gear pump market. Based on our market survey, we believe acceptance of its product in the replacement market is good. We expect sales contribution from the replacement market to grow over the next two years. The management plans to achieve a 50:50 mix of OEM sales and replacement market sales. We believe the company will gradually be able to increase its market share in the aftermarket by leveraging its robust distribution channel of 50 distributors and 500 stockists.

Figure 10: Volume sales from the replacement market to grow gradually



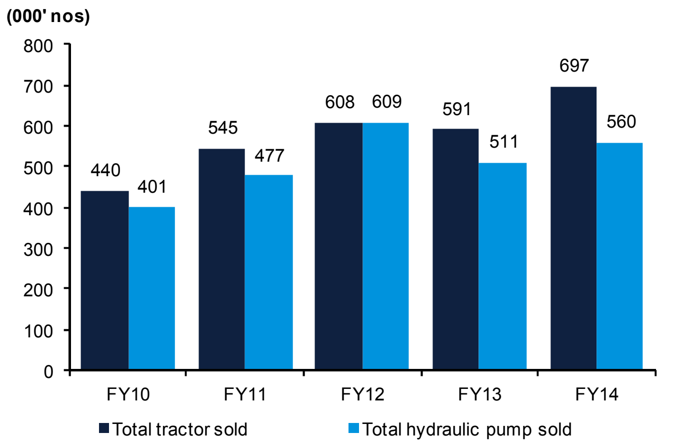
Source: Company, CRISIL Research

Healthy long-term prospects of the industry despite a grim short term

Over the next five years, CRISIL Research expects tractor demand to grow at 8-10% CAGR. Domestic tractor sales posted a strong growth of 19-21% y-o-y in FY14. However, domestic tractor sales volumes are projected to be flat in FY15 as rabi crop output was impacted by unseasonal rainfall in key agrarian states and sub-normal monsoon.

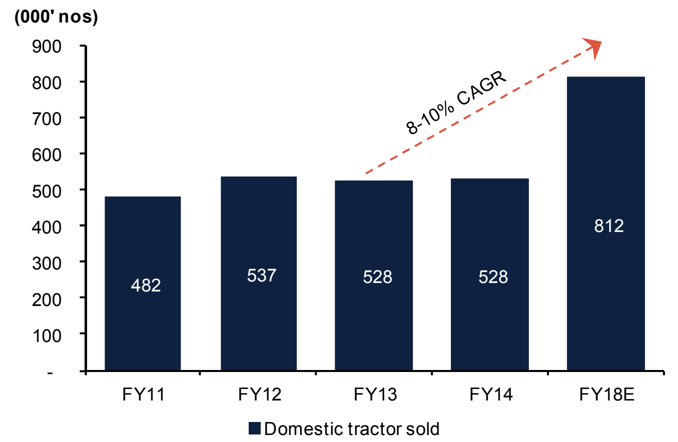
The hydraulics segment's growth is highly correlated with industry growth as Dynamatic is a dominant player in the Indian hydraulic gear pump industry. Hence, it is likely to benefit from the industry-wide growth.

Figure 11: Strong correlation with total tractor sales



Source: Company, CRISIL Research

Figure 12: Tractor sales expected to grow at 8-10% CAGR



Source: Company, CRISIL Research

Increasing cost of farm labour due to employment schemes such as Mahatma Gandhi National Rural Employment Guarantee Act, increasing farm incomes and credit availability, rising substitution of non-mechanised modes such as animal labour, and increased focus of the government on agricultural and rural development are expected to drive tractor sales.

Increase in farm incomes to drive tractor sales: Over the past decade, growth in tractor sales primarily followed growth in farm incomes. Tractor sales grew 11% CAGR over the past five years and 9% over the past 10 years. Farm incomes (product of four major crops and their MSPs) are estimated to have grown at a CAGR of 15% and 10% over the corresponding period. CRISIL Research expects farm incomes to grow at a healthy rate with an improvement in irrigation facilities and continued government support.

Increase in non-farm usage: Currently, non-farm usage accounts for 30% of the demand for tractors. Tractor usage in non-farm activities has been increasing as the government's focus on improving rural infrastructure increases. Tractors are used for carrying construction material such as bricks, cement and pipes. Tractors are also being looked at as an alternative to commercial vehicles as they are more economical, can carry heavy weight and can manoeuvre easily on rough, rural roads.

The UK business is expected to face challenges

The UK business' (contributed 9% to FY14 total revenues) strong sales volume in FY14 has enabled the plant to continue to run a full-day shift and maintain the small twilight shift to run the key equipment. Higher sales volume coupled with its lean initiatives improved its profitability in FY14 (7% EBITDA margin vs 1% in FY13). However, the UK business is expected to be a drag on the segment's revenue growth in FY15 as it may not be able to reach optimal utilisation levels as orders for one of its main OEM tractor platforms in CNH Brazil, Womack military vehicle contract and gear pump business in Gima, France were completely executed in FY14. This is expected to have a significant impact on the UK business' sales in FY15 which is likely to offset somewhat by anticipated increases in sales with Alexander Dennis in the UK and CNH aftermarket sales in France.

Key Risks

High dependence on one client

Dynamatic's Indian auto division derives close to 41% of revenues (4.4% of consolidated revenues) from sales to Hyundai which exposes it to the risk of customer concentration. Any adverse impact on the sales of Hyundai vehicles will pose a significant downside to Dynamatic's sales. Although the company is focusing on expanding its revenues from other customers to reduce the exposure to Hyundai, its dependence on this client remains high.

Exposed to cyclicality of end-user industries

Post acquisition of Eisenwerk Erla in FY12, Dynamatic has become highly dependent on the automobile industry, which accounted for close to 66% of its revenues in FY14. The auto industry is highly susceptible to economic cycles, changes in interest rates and fuel costs, and varying demand patterns. Changes in economic cycles and interest rates can hamper the consumers' ability to spend or result in postponement of consumption. Increase in fuel costs could lead to lower profitability of the transporters which will hamper the sale of commercial vehicles. These factors will have a negative impact on the sale of auto manufacturers and could lead to lower demand for auto components.

OEMs have a strong bargaining power

OEMs enjoy a strong bargaining power with their suppliers and are known to squeeze them. In the past, OEMs have refused to absorb the increase in cost which led to margin pressure for auto component suppliers.

Quarterly results analysis (Q1FY15)

Dynamatic's Q1FY15 consolidated results, ex-exceptional item, were above CRISIL Research's expectations. Consolidated revenues grew 19.8% y-o-y to ₹4,250 mn driven by robust performance across all the segments. EBITDA margin expanded by 253 bps y-o-y to 10.9% led by 540 bps y-o-y margin expansion in the auto segment. Adjusting for exceptional charge of ₹226 mn incurred as a part of the company's deleveraging and refinancing exercise, PAT improved to ₹115 mn from a loss of ₹89 mn in Q1FY14. Monetisation of the non-core asset (windmill) by FY15-end is expected to deleverage its balance sheet further. We expect the management to focus on business growth due to easing in the availability of capital.

Aerospace: Strong order execution resulted in robust growth

The aerospace segment's revenues grew 30.5% y-o-y to ₹593 mn due to strong execution of the existing orders. However, EBITDA declined 10.2% y-o-y to ₹137 mn because the company incurred expenses on facilities to execute new orders. The company expects new orders to start contributing to revenues from Q4FY15. We expect this segment's revenues to grow at a CAGR of 25% over FY14-16.

Auto: German division's performance robust; higher profits due to better product mix

The Indian auto division's revenues declined 8.6% y-o-y to ₹428 mn (15% of auto revenues) and the German division's revenues grew 26.7% y-o-y to ₹2,445 mn driven by higher sales volume. The German division's EBITDA margin expanded by 240 bps y-o-y to 8.9% and the Indian division's margin improved to 0.2% from -15.5% in Q1FY14 due to a better product mix. We expect significant improvement in profitability in the Indian auto division as we expect higher sales growth in the domestic auto industry on account of the expected macro-improvement following a decisive mandate at the general elections.

Hydraulics: Indian division's performance steady; the UK division's performance muted

The Indian hydraulics division's revenues grew 22.1% y-o-y to ₹457 mn (58% of hydraulics revenues) driven by strong demand from the agriculture sector. However, the UK division's revenues grew 1.8% y-o-y to ₹325 mn. The UK division's EBITDA margin contracted by 50 bps y-o-y due to higher employee cost and payment of management fee while the Indian division's margin contracted by 180 bps, which is likely due to lease rent as the company has shifted its plant in Bengaluru from its premises to three leased premises in Q4FY14; each unit is geared to cater to the market demand for specific products. We expect the Indian unit's performance to be steady while the UK business' performance is a monitorable.

Profitability impacted due to one-time exceptional expense; expected to improve

In Q1FY15, the company incurred a one-time exceptional expense of ₹226 mn on refinancing, prepayment of debt and cancellation of interest rate swaps (IRS), which impacted its profitability (offset by lower interest and depreciation expenses). It fully prepaid the high-cost loan of ₹600 mn from KKR in the beginning of the quarter which has reduced its overall cost of debt from 20% plus to 15%. It also refinanced a €18 mn loan at its German operations with lower cost of debt of 3.8% vs 6.8% earlier. The management expects to reduce debt by ₹1,000 mn in FY15 through the sale of non-core asset (windmill). We expect its interest burden to reduce and profitability to improve going ahead.

Table 5: Q1FY15 Results Summary (Consolidated)

(₹ mn)	Q1FY15	Q4FY14	Q1FY14	q-o-q (%)	y-o-y (%)
Net sales	**4,250**	**4,304**	**3,548**	**(1.3)**	**19.8**
Raw materials cost	2,454	2,441	2,016	0.5	21.7
Raw materials cost (% of net sales)	57.8%	56.7%	56.8%	104bps	92bps
Other expenses	596	608	493	(2.1)	20.8
Employee cost	737	829	742	(11.1)	(0.7)
EBITDA	**463**	**426**	**297**	**8.7**	**56.1**
EBITDA margin	**10.9%**	**9.9%**	**8.4%**	**100bps**	**253bps**
Depreciation	122	128	128	(4.7)	(5.1)
EBIT	**341**	**298**	**168**	**14.4**	**102.7**
Interest and finance charges	214	259	234	(17.7)	(8.8)
Operating PBT	**127**	**39**	**(66)**	**230.3**	**NM**
Other income	11	122	15	(90.8)	(23.9)
Exceptional item	(226)	(18)	(15)	-	-
PBT	**(87)**	**143**	**(66)**	**NM**	**NM**
Tax	23	29	38	(19.0)	(38.3)
PAT	**(110)**	**115**	**(104)**	**NM**	**NM**
Adj PAT	**115**	**132**	**(89)**	**(12.6)**	**NM**
Adj PAT margin	**2.7%**	**3.1%**	**-2.5%**	**-35bps**	**NM**
No. of equity shares (mn)	5.8	5.5	5.4	-	-
Adj EPS (₹)	**20.0**	**23.8**	**(16.4)**	**(15.9)**	**NM**

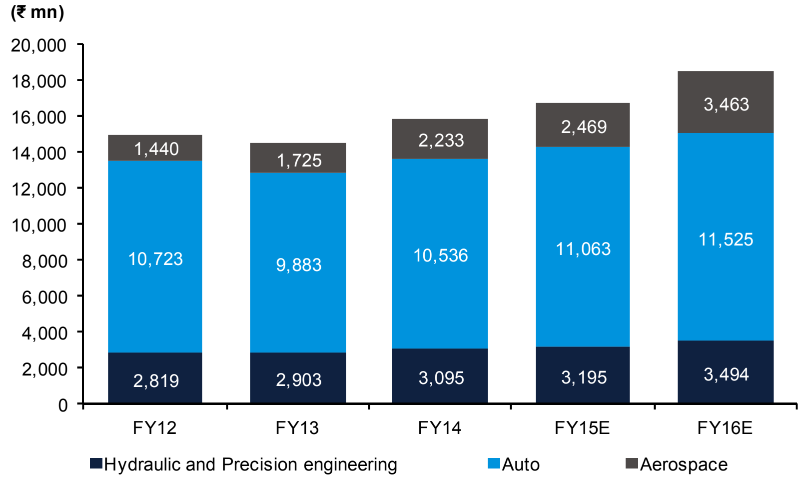
Source: Company, CRISIL Research

Financial Outlook

Revenues to grow at a CAGR of 8% over the next two years

Dynamatic's consolidated revenues are estimated to grow at a CAGR of 8.3% to ₹18.6 bn over FY14-16. The hydraulic and aerospace segments are estimated to grow at 6.3% and 24.5% CAGR, respectively, over the same period. The auto component segment is expected to grow at 4.6% CAGR as the domestic auto business is expected to recover due to improvement in the macro-environment (expected to contribute 66% to revenues in FY15).

Figure 13: Revenues to grow at 8% CAGR



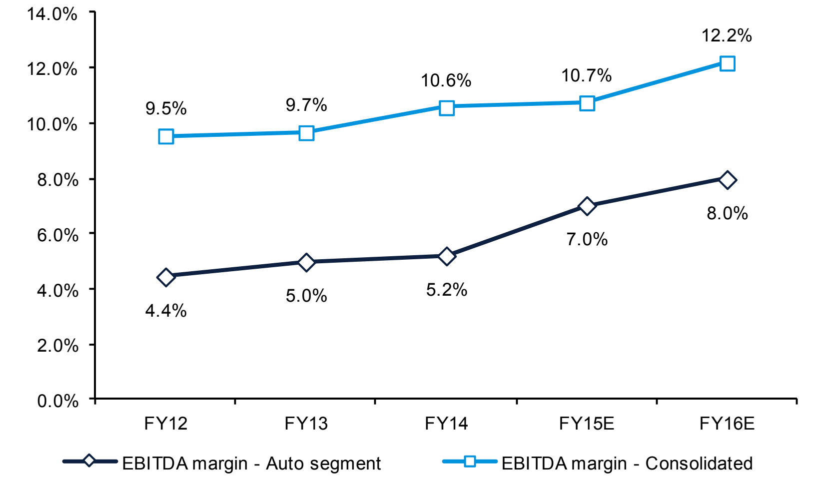
Source: Company, CRISIL Research

EBITDA margin to recover with improvement in auto business

Dynamatic's EBITDA margin is expected to expand by 161 bps to 12.2% in FY16 from 10.6% in FY14. The expansion is likely to be driven by an improvement in the profitability of the auto segment, whose EBITDA margin is expected to improve by 276 bps to 8.0% in FY16 from 5.2% in FY14.

The auto segment's margins were under pressure during FY13-14 because (1) the company's domestic auto business' margins were under pressure due to weak demand and (2) the Chennai-based iron foundry was facing power-related issues and was undergoing trial runs for its new horizontal line, which resulted in high raw material and other operating costs. However, now the problems have been resolved with adequate supply of power, the stabilisation of the iron foundry's new line and rationalisation of product mix.

Figure 14: Auto segment's recovery to drive EBITDA margin



Source: Company, CRISIL Research

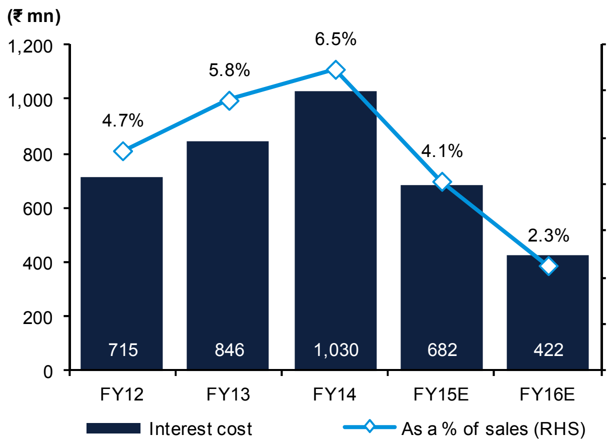
Net debt/equity ratio to come down to 0.9x in FY16

The company is expected to repay ₹2,100 mn debt by FY15 using the proceeds from the QIP, monetisation of the non-core asset (windmill) and cash flows from the expected strong operating performance over FY14-16. The non-core asset sale is likely to fetch ₹500 mn. The net debt/equity ratio is expected to come down to 0.9x in FY16 from 4.3x in FY14 and interest cost is estimated to drop to ₹422 mn in FY16 from ₹1,030 mn in FY14.

Adjusted PAT to grow to ₹911 mn in FY16 driven by lower interest and depreciation expenses

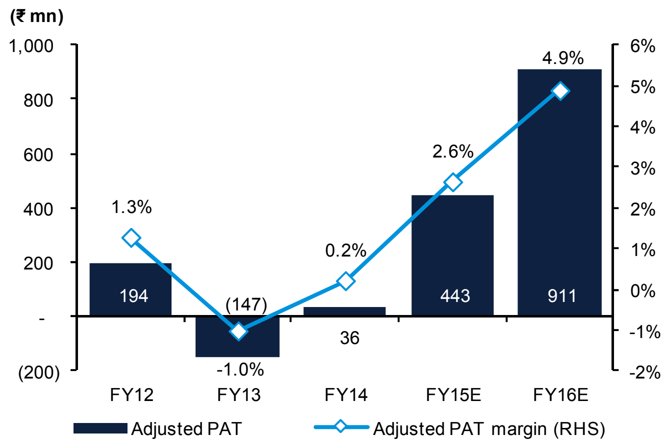
Adjusted PAT (adjusted for the asset sale) is expected to grow at a two-year CAGR of 406% to ₹911 mn in FY16 owing to a low base in FY14. Improvement in profitability and declining interest cost are likely to fuel this growth. The company's debt is expected to decline to ₹3,745 mn in FY16 from ₹6,150 mn in FY14 as it will repay the debt using the proceeds from the QIP and the non-core assets sales. The company is expected to report EPS of ₹69.9 and ₹143.6 in FY15 and FY16 respectively.

Figure 15: Declining interest cost...



Source: Company, CRISIL Research

Figure 16: ... to support PAT margin expansion



Source: Company, CRISIL Research

Management Overview

CRISIL's fundamental grading methodology includes a broad assessment of management quality, apart from other key factors such as industry and business prospects, and financial performance.

Experienced and aggressive management

Dynamatic is headed by Mr Udayant Malhoutra - promoter, CEO and managing director. Under his leadership, the company concluded three acquisitions to boost all the three business segments, out of which two were debt-funded.

Quick in identifying new opportunities

Dynamatic's management has been quick in identifying new growth avenues and capitalising on them. Having started as a hydraulic gear pumps manufacturer, it diversified into auto component manufacturing. Then it entered the high-margin business of manufacturing defence equipment and fabrication of aerospace components. It acquired Oldland Aerospace Ltd in FY09 and secured single source supplier status from Airbus for FTB for the A320 family of aircraft. This segment has generated EBITDA higher than the acquisition cost over the past five years. In FY12, to integrate its auto component business, the management acquired an iron foundry through the acquisition of Eisenwerk Erla, Germany. This is expected to support profitability going ahead.

Professional set-up and strong second line

The company has inducted various professionals from the industry at the senior and mid management levels to prepare for the next level of growth. Each segment is headed by experienced personnel.

Mr Hanuman Sharma: Inducted as CFO in FY12. He is a qualified chartered accountant and has over 16 years of experience in the automotive industry.

Dynamatic has an experienced management

Mr P S Ramesh: COO, hydraulic division; with Dynamatic since 1999. He is a mechanical engineer from IIT, Madras. He was with the quality assurance group of HAL for over two decades.

Mr Uppili S: Executive director - JKM Ferrotech Ltd and director - JKM Erla Automotive Ltd. He has about 26 years of experience in the automotive industry; has earlier worked with Igrashi Motors India Ltd as Chief of Operations.

Mr G Parasurami Reddy: COO, Dynamatic-Oldland Aerospace. He is a mechanical engineer with a post graduate degree in machine design from the Indian Institute of Science, Bengaluru. He has worked with HAL since 1968 and was involved with the development of some of India's major aircraft including Kiran MK II, Ajeet Trainer and HJT 34.

Corporate Governance

CRISIL's fundamental grading methodology includes a broad assessment of corporate governance and management quality, apart from other key factors such as industry and business prospects, and financial performance. In this context, CRISIL Research analyses the shareholding structure, board composition, typical board processes, disclosure standards and related-party transactions. Any qualifications by regulators or auditors also serve as useful inputs while assessing a company's corporate governance.

Overall, corporate governance at Dynamatic meets the regulatory requirement – it has reasonably good board practices and an independent board.

Corporate governance practices are good

Board composition

Dynamatic's board comprises nine members, of whom six are independent directors, which is in compliance with the requirement under Clause 49 of SEBI's listing guidelines. The directors have strong industry experience and are highly qualified. Most of the directors are formidable names in their business lines. Given the background of directors, we believe the board is well experienced. The independent directors have a fairly good understanding of the company's business and its processes.

Table 6: Profile of independent directors

Name	Age	Year of appointment	Qualification/background
Mr Vijai Kapur	83	1992	Has served as the deputy managing director of GKW Ltd and president of CII
Air Chief Marshal S. Krishnaswamy (Retd.)	71	2005	Post graduate degree in military sciences
Mr Govind Mirchandani	63	2008	Graduate from IIT Mumbai and PGDM from IIM-Kolkata
Ms. Malavika Jayaram	43	2008	Integrated BA-LLB degree from National Law School of India and Master of Law (LLM) from North-western University, Chicago. She has also specialised in computer law, intellectual property rights, international business transactions and EU law
Mr Nalini Ranjan Mohanty	69	2013	Mechanical engineering from NIT, Rourkela. Was chairman of HAL in 2001, and chairman and managing director of Textron for six years
Mr Ramesh Venkataraman	48	2013	B.Tech in electronics and communications engineering from IIT – Kharagpur and an M.Phil. in international relations from Oxford University

Board's processes

The company has all the necessary committees – audit, remuneration, nomination, technical development and investor grievance – in place to support corporate governance practices. The audit committee is chaired by an independent director, Mr Vijai Kapur.

Good disclosures

The company's disclosures can be considered good judged by the level of information and details furnished in the annual report, websites and other publicly available data.

CRISIL RESEARCH

Valuation Grade: 3/5

We continue to use the DCF method to value Dynamatic and have arrived at a fair value of ₹1,933 per share. The stock is currently trading at ₹2,010 per share. The implied forward P/E multiple is 13.5x FY16 EPS. The valuation grade is '3/5'.

Key DCF assumptions

We have considered the discounted value of the firm's estimated free cash flows from FY15 to FY23. We have assumed a terminal growth rate of 3% beyond the explicit forecast period until FY23.

WACC computation

	FY15-23	Terminal value
Cost of equity	16.8%	16.8%
Cost of debt (post tax)	7.3%	7.3%
WACC	**13.4%**	**13.4%**
Terminal growth rate	3%	3%

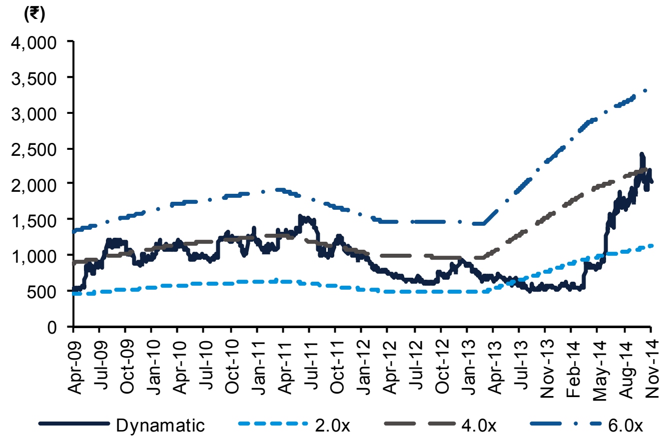
Terminal WACC	1.0%	2.0%	3.0%	4.0%	5.0%
11.4%	2,133	2,293	2,597	2,743	3,073
12.4%	1,876	2,000	2,229	2,336	2,572
13.4%	1,660	1,758	**1,933**	2,016	2,191
14.4%	1,478	1,556	1,695	1,757	1,890
15.4%	1,321	1,384	1,495	1,544	1,647

Peer valuation comparison

			Price to earnings ratio (P/E) (x)			Price to book ratio (P/B) (x)			EV/EBITDA (x)			RoE (%)		
	Currency	M-Cap	FY14	FY15E	FY16E	FY14	FY15E	FY16E	FY14	FY15E	FY16E	FY14	FY15E	FY16E
Dynamatic Technologies*	**₹ bn**	**10**	**NM**	**26.7**	**12.9**	**7.7**	**4.6**	**3.4**	**9.5**	**8.4**	**6.7**	**2.7**	**22.2**	**30.4**
Auto component manufacturers														
Domestic														
Motherson Sumi Systems Ltd	₹ bn	346	45.1	28.3	19.4	11.7	9.0	6.7	15.2	11.2	8.4	29.2	36.3	40.0
Setco Automotive Ltd	₹ bn	5	18.5	18.4	10.7	2.7	2.4	2.0	18.0	11.3	8.5	9.8	13.6	19.8
Sundram Fasteners Ltd	₹ bn	28	23.2	18.3	14.0	3.6	3.0	2.5	13.7	11.1	8.9	16.4	18.0	20.2
Munjal Showa Ltd	₹ bn	7	10.5	9.5	7.9	2.1	1.8	1.5	6.4	5.4	4.6	21.2	19.2	19.7
Median			**20.8**	**18.3**	**12.3**	**3.1**	**2.7**	**2.3**	**14.4**	**11.2**	**8.5**	**18.8**	**18.6**	**20.0**

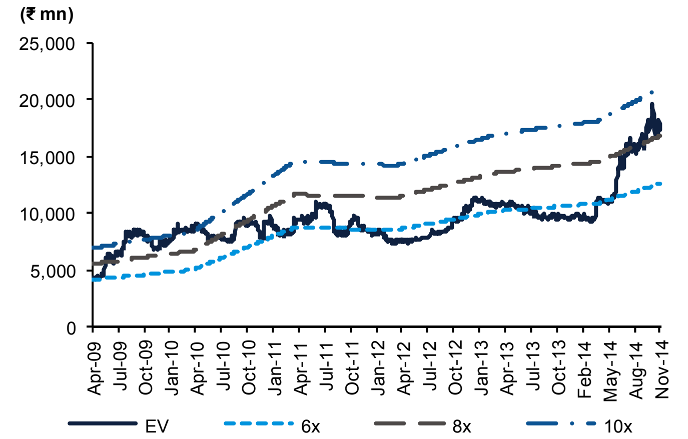
Source: Industry, CRISIL Research*

One-year forward P/B band



Source: NSE, CRISIL Research

One-year forward EV/EBITDA band

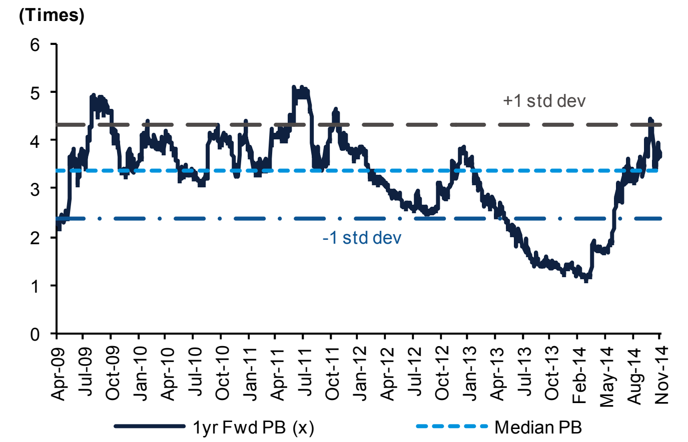


Source: NSE, CRISIL Research

P/E – premium / discount to CNX 500

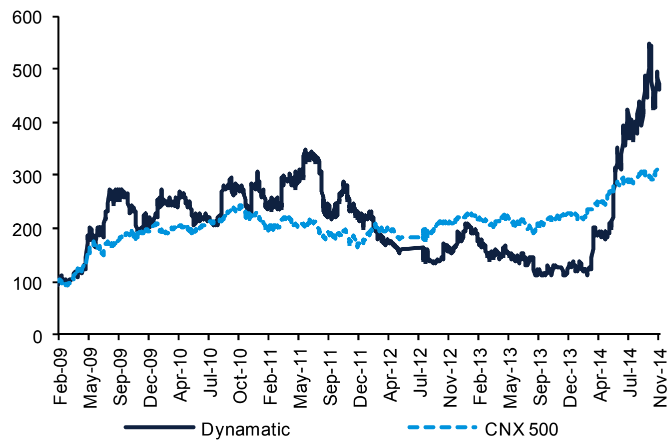
Source: NSE, CRISIL Research

P/B movement



Source: NSE, CRISIL Research

Share price movement



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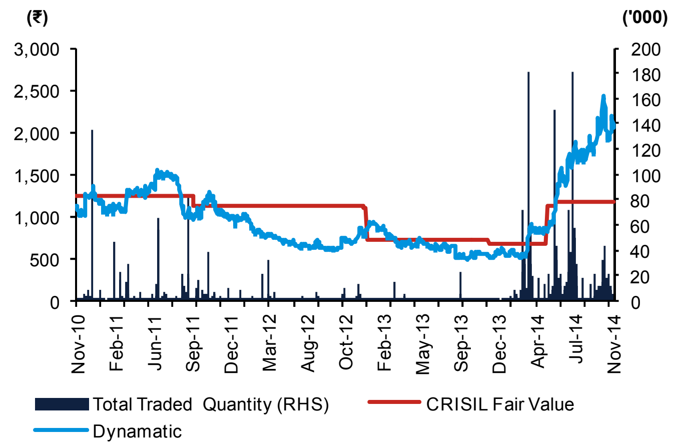
Source: NSE, CRISIL Research

Fair value movement since initiation



Source: NSE, BSE, CRISIL Research

Earnings Estimates Revised Upwards

	FY15E			FY16E		
₹ mn	Old	New	Change	Old	New	Change
Operating income	16,587	16,738	1%	18,146	18,639	3%
EBITDA	1,769	1,797	2%	2,327	2,269	-2%
EBITDA margin	10.7%	10.7%	4bps	12.8%	12.2%	-63bps
Interest cost	702	682	-3%	484	422	-13%
Exceptional inc/(exp)	800	295	-63%	0	0	0%
Adjusted PAT	380	443	17%	843	911	8%
PAT margin	2.3%	2.6%	35bps	4.6%	4.9%	29bps
Adjusted EPS (₹)	62.9	69.9	11%	139.6	143.6	3%

Source: CRISIL Research estimates

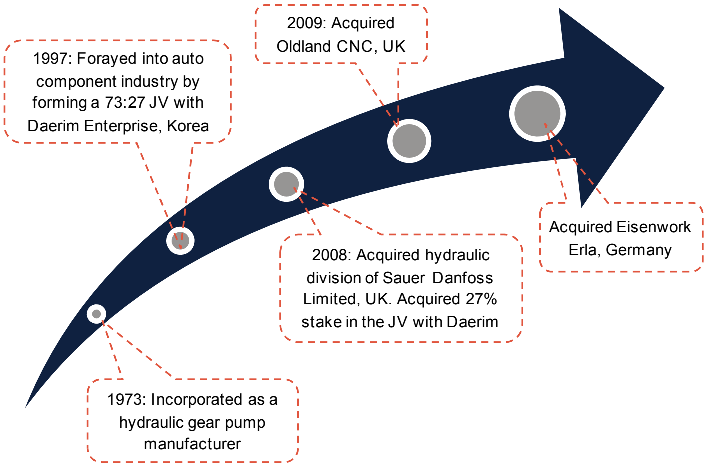
CRISIL IER reports released on Dynamatic Technologies Ltd

Date	Nature of report	Fundamental grade	Fair value	Valuation grade	CMP (on the date of report)
19-Nov-10	Initiating coverage	4/5	₹1,241	3/5	₹1,182
08-Mar-11	Q3FY11 result update	4/5	₹1,241	4/5	₹1,100
09-Jun-11	Q4FY11 result update	4/5	₹1,241	3/5	₹1,350
30-Sep-11	Q1FY12 result update	4/5	₹1,131	3/5	₹1,100
29-Nov-11	Q2FY12 result update	4/5	₹1,131	3/5	₹1,037
17-Feb-12	Q3FY12 result update	4/5	₹1,131	5/5	₹902
03-Oct-13	Detailed report	3/5	₹712	5/5	₹495
12-Dec-13	Q2FY14 result update	3/5	₹674	5/5	₹505
21-Feb-14	Q3FY14 result update	3/5	₹674	4/5	₹547
22-May-14	Event update	3/5	₹1,121	4/5	₹910
12-June-14	Q4FY14 result update	3/5	₹1,170	2/5	₹1,375
11-Nov-14	Detailed report	3/5	₹1,933	3/5	₹2,010

Company Overview

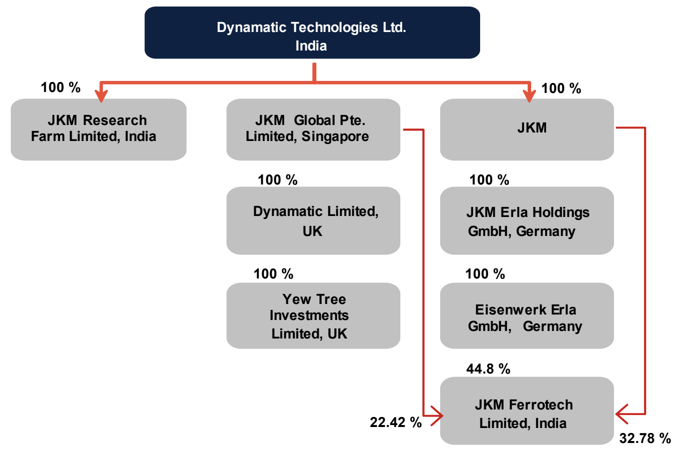
Incorporated in 1973, Bengaluru-based Dynamatic manufactures auto components, aero structures and hydraulic gear pumps. The company began as a hydraulic gear pump manufacturer, forayed into auto components, and then into the aerospace industry. It derives revenues from three segments: hydraulic precision engineering (tractors and earth moving equipment), auto components and aerospace. The operations of these divisions are supported by two captive foundries – aluminium and iron – in Chennai that manufacture castings, a key raw material.

Dynamatic's journey



Source: Company, CRISIL Research

Group structure



Source: Company, CRISIL Research

List of acquisitions

Year	Acquired	Segment	Based in	Acquisition price	CRISIL comments
FY08	Loss-making hydraulic business division of Sauer Danfoss Ltd	Hydraulics	the UK	US$10 mn (~₹360 mn)	Acquisition provided global reach to serve OEMs such as CNH, John Deere, etc.
FY09	Oldland CNC	Aerospace	the UK	US$16 mn (~₹730 mn)	Gained complex five axis machining capabilities. Access to marquee clients such as Airbus and Boeing
FY12	Germany-based Eisenwerk Erla	Automotive components	Germany	€ 26.4 mn (~₹3,000 mn)	Access to global auto OEM hub and blue chip customers such as BMW, Audi, Daimler, Volkswagen, Ford, Getrag, etc.

Source: Company, CRISIL Research

Eisenwerk Erla was earlier acquired by the Sanmar Group to foray into auto component manufacturing. The iron foundry was set up in Chennai by Eisenwerk Erla (due to space constraints in Germany) to support its German operations. Sanmar Group sold the company as it required cash to reduce debt incurred following its acquisition of a chemical company in Egypt.

Has vertically integrated facilities

Manufacturing facility

Dynamatic's manufacturing facilities are in India, the UK and Germany. In India, the company has set up hydraulics and aerospace facilities in Bengaluru, an aerospace assembly facility in

Nasik and an auto components unit in Chennai. It has a wind farm in Coimbatore to feed its power requirements. Dynamatic also has an aluminium foundry and an iron foundry, and two machining facilities in Chennai. In the UK, the company acquired hydraulics and aerospace precision engineering units. In Germany, it acquired an auto component manufacturing company (second oldest factory in Germany with over 650 years of existence) which is capable of manufacturing highly intricate castings.

Strong R&D

Dynamatic owns 18 patents for its various products in India and internationally. In addition, it has two patents pending in multiple jurisdictions, awaiting registration. It has nine trademarks registered and 11 trademark applications pending awaiting registration. It has the design intellectual property (IP) for all the products manufactured in the hydraulics segment. It employs over 60 scientists and 600 engineers and technicians with expertise across various streams in India and internationally. Its UK hydraulics plant has over 50 years of experience in gear pump design.

Milestones

1973	Incorporated as Dynamatic Hydraulics Ltd
1974	IPO
1992	Changed the name to Dynamatic Technologies Ltd
1998	JKM Daerim Automotive Ltd, a 73:27 joint venture between Dynamatic and Daerim Enterprise Co. was formed
2002	HAL Best Vendor Award by HAL's aircraft division
2007	Acquired hydraulic business division (Swindon unit) of Sauer Danfoss Ltd, the UK for US$10 mn
2008	Dynamatic acquired 100% stake in JKM Daerim and merged it
2008	Acquired a 12 MW wind farm for captive consumption of JKM Automotive and Dynametal
2008	Raised ₹745 mn through a QIP placement of 604,000 equity shares to FID Funds (Mauritius) Ltd, New Vernon India Ltd and Credit Suisse (Singapore) Ltd
2008	Acquired Oldland CNC Ltd, Bristol, the UK for US$16 mn
2010	Secured 27.5-acre land in Bengaluru's upcoming Aerospace Industrial Estate
2012	Acquired Eisenwerk Erla, Germany for €26.4 mn
2013	Equity infusion by promoter group of ₹125 mn through warrants conversion
2014	Equity infusion by promoter group of ₹375 mn through warrants conversion

Source: Company

Annexure: Financials (Consolidated)

Income statement

(₹ mn)	FY12	FY13	FY14	FY15E	FY16E
Operating income	**15,103**	**14,542**	**15,900**	**16,738**	**18,639**
EBITDA	**1,441**	**1,405**	**1,680**	**1,797**	**2,269**
EBITDA margin	**9.5%**	**9.7%**	**10.6%**	**10.7%**	**12.2%**
Depreciation	439	467	513	514	516
EBIT	**1,002**	**938**	**1,167**	**1,283**	**1,753**
Interest	715	846	1,030	682	422
Operating PBT	**287**	**92**	**137**	**601**	**1,332**
Other income	12	4	19	71	48
Exceptional inc/(exp)*	52	28	102	295	-
PBT	**352**	**123**	**258**	**966**	**1,380**
Tax provision	106	242	120	228	469
Minority interest	-	-	-	-	-
PAT (Reported)	**246**	**(119)**	**138**	**738**	**911**
Less: Exceptionals	52	28	102	295	-
Adjusted PAT	**194**	**(147)**	**36**	**443**	**911**

Ratios

	FY12	FY13	FY14	FY15E	FY16E
Growth					
Operating income (%)	201.1	(3.7)	9.3	5.3	11.4
EBITDA (%)	75.5	(2.5)	19.6	7.0	26.3
Adj PAT (%)	(13.1)	(175.5)	(124.3)	1,144.6	105.5
Adj EPS (%)	(13.0)	(175.5)	(123.7)	987.3	105.5
Profitability					
EBITDA margin (%)	9.5	9.7	10.6	10.7	12.2
Adj PAT Margin (%)	1.3	(1.0)	0.2	2.6	4.9
RoE (%)	11.9	(9.6)	2.7	20.4	26.5
RoCE (%)	14.4	10.8	14.7	17.6	23.9
RoIC (%)	13.7	8.5	14.7	17.9	20.3
Valuations					
Price-earnings (x)	22.3	NM	NM	28.8	14.0
Price-book (x)	2.5	2.7	8.3	4.2	3.3
EV/EBITDA (x)	7.9	7.2	10.0	9.0	7.1
EV/Sales (x)	0.8	0.7	1.1	1.0	0.9
Dividend payout ratio (%)	17.6	-	-	1.7	3.4
Dividend yield (%)	1.0	-	-	0.1	0.2
B/S ratios					
Inventory days	54	60	63	65	74
Creditors days	84	86	89	94	81
Debtor days	58	36	23	28	28
Working capital days	36	17	10	12	31
Gross asset turnover (x)	2.5	1.8	1.8	1.8	2.0
Net asset turnover (x)	3.7	2.6	2.7	3.0	3.8
Sales/operating assets (x)	3.0	2.2	2.6	3.0	3.5
Current ratio (x)	1.5	1.4	1.2	1.3	1.5
Debt-equity (x)	4.2	5.3	4.6	1.4	1.0
Net debt/equity (x)	4.1	4.9	4.3	1.1	0.9
Interest coverage					
EBIT/Interest	1.4	1.1	1.1	1.9	4.2
EBITDA/Interest	2.0	1.7	1.6	2.6	5.4

Per share

	FY12	FY13	FY14	FY15E	FY16E
Adj EPS (₹)	35.9	(27.1)	6.4	69.9	143.6
CEPS	117.0	59.2	99.0	151.0	224.9
Book value	319.6	245.4	241.2	473.0	610.8
Dividend (₹)	8.0	-	-	2.0	4.9
Actual o/s shares (mn)	5.4	5.4	5.5	6.3	6.3

Balance Sheet

(₹ mn)	FY12	FY13	FY14	FY15E	FY16E
Liabilities					
Equity share capital	54	54	55	63	63
Reserves	1,675	1,274	1,281	2,936	3,810
Net worth	**1,729**	**1,328**	**1,336**	**2,999**	**3,873**
Convertible debt	-	-	-	-	-
Other debt	7,284	7,015	6,150	4,065	3,745
Total debt	**7,284**	**7,015**	**6,150**	**4,065**	**3,745**
Deferred tax liability (net)	184	313	341	434	449
Total liabilities	**9,196**	**8,656**	**7,827**	**7,499**	**8,068**
Assets					
Net fixed assets	5,349	5,671	5,967	5,028	4,813
Capital WIP	1,153	755	48	300	500
Total fixed assets	**6,502**	**6,426**	**6,016**	**5,328**	**5,313**
Investments	**44**	**51**	**45**	**45**	**45**
Current assets					
Inventory	1,914	2,025	2,280	2,476	3,064
Sundry debtors	2,463	1,461	1,016	1,273	1,419
Loans and advances	719	672	869	915	1,019
Cash & bank balance	196	545	436	684	282
Marketable securities	-	-	-	-	-
Total current assets	**5,292**	**4,703**	**4,602**	**5,348**	**5,783**
Total current liabilities	**3,555**	**3,483**	**3,737**	**4,111**	**3,938**
Net current assets	**1,737**	**1,221**	**864**	**1,238**	**1,846**
Intangibles/Misc. expenditure	**913**	**958**	**902**	**888**	**864**
Total assets	**9,196**	**8,656**	**7,827**	**7,499**	**8,068**

Cash flow

(₹ mn)	FY12	FY13	FY14	FY15E	FY16E
Pre-tax profit	300	96	156	671	1,380
Total tax paid	(192)	(113)	(92)	(135)	(454)
Depreciation	439	467	513	514	516
Working capital changes	(440)	866	248	(126)	(1,010)
Net cash from operations	**107**	**1,316**	**824**	**925**	**431**
Cash from investments					
Capital expenditure	(3,974)	(436)	(46)	188	(477)
Investments and others	(44)	(7)	6	-	-
Net cash from investments	**(4,017)**	**(443)**	**(40)**	**188**	**(477)**
Cash from financing					
Equity raised/(repaid)	(20)	-	208	940	-
Debt raised/(repaid)	3,961	(269)	(865)	(2,085)	(320)
Dividend (incl. tax)	(51)	(2)	-	(15)	(36)
Others (incl extraordinaries)	60	(253)	(235)	295	0
Net cash from financing	**3,951**	**(523)**	**(892)**	**(865)**	**(356)**
Change in cash position	40	349	(109)	248	(402)
Closing cash	196	545	436	684	282

Quarterly financials

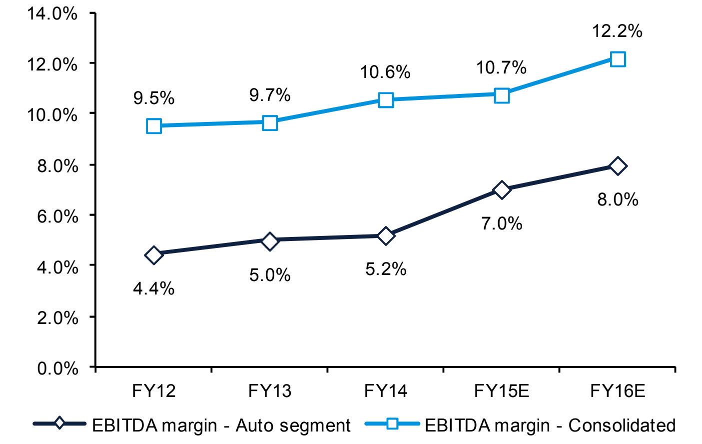
(₹ mn)	Q1FY14	Q2FY14	Q3FY14	Q4FY14	Q1FY15
Net Sales	**3,548**	**4,024**	**3,999**	**4,304**	**4,250**
Change (q-o-q)	-8%	13%	-1%	8%	-1%
EBITDA	**297**	**474**	**433**	**426**	**463**
Change (q-o-q)	-4%	60%	-9%	-2%	9%
EBITDA margin	**8.4%**	**11.8%**	**10.8%**	**9.9%**	**10.9%**
PAT	(104)	70	39	115	-110
Adj PAT	**(89)**	**70**	**39**	**132**	**115**
Change (q-o-q)	-59%	-179%	-44%	236%	-13%
Adj PAT margin	**-3%**	**2%**	**1%**	**3%**	**3%**
Adj EPS	**(16.4)**	**13.0**	**7.3**	**23.8**	**20.0**

** Figures are net of tax*

Source: Company, CRISIL Research

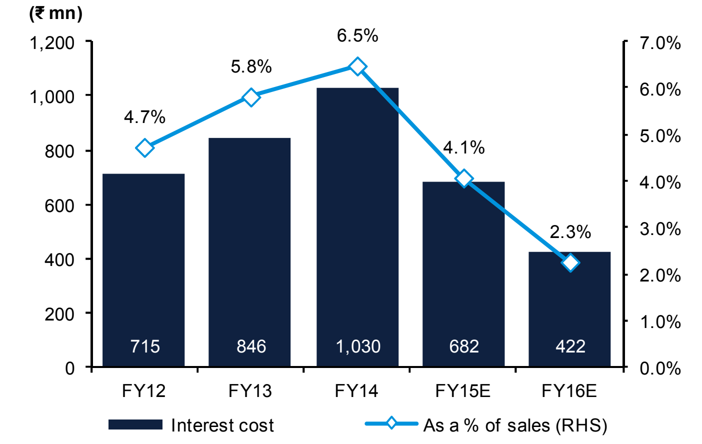
Focus Charts

Auto segment's profitability improvement to push margins



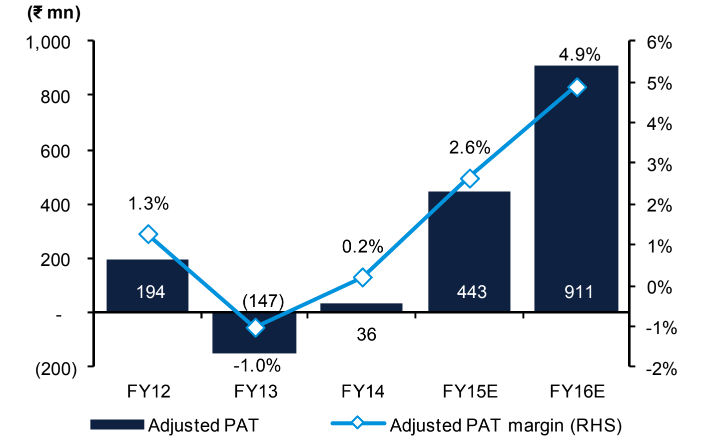
Source: Company, CRISIL Research

Debt repayment to reduce the interest burden



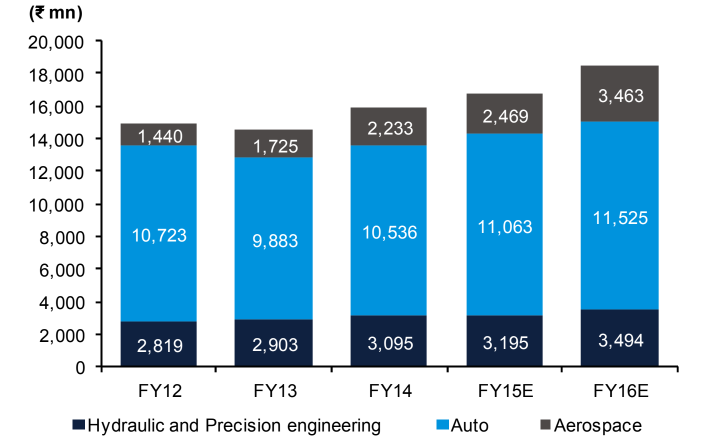
Source: Company, CRISIL Research

PAT to grow to ₹911 mn in FY16



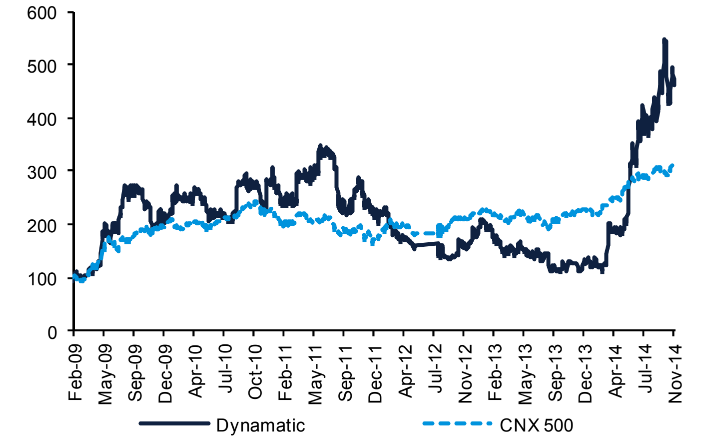
Source: Company, CRISIL Research

Revenues to grow at 8% CAGR over FY14-16



Source: Company, CRISIL Research

Share price movement since initiation



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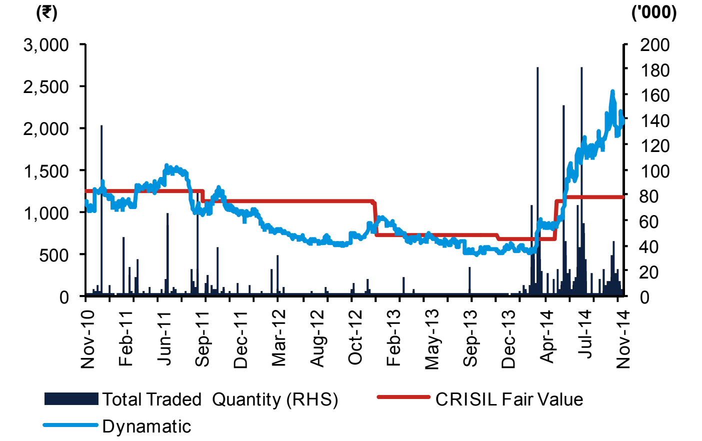
Source: NSE, BSE, CRISIL Research

Share price movement vis-à-vis CNX 500



Source: NSE, CRISIL Research

CRISIL Research Team

President

Mukesh Agarwal	CRISIL Research	+91 22 3342 3035	mukesh.agarwal@crisil.com

Analytical Contacts

Sandeep Sabharwal	Senior Director, Capital Markets	+91 22 4097 8052	sandeep.sabharwal@crisil.com
Prasad Koparkar	Senior Director, Industry & Customised Research	+91 22 3342 3137	prasad.koparkar@crisil.com
Binaifer Jehani	Director, Customised Research	+91 22 3342 4091	binaifer.jehani@crisil.com
Manoj Mohta	Director, Customised Research	+91 22 3342 3554	manoj.mohta@crisil.com
Sudhir Nair	Director, Customised Research	+91 22 3342 3526	sudhir.nair@crisil.com
Mohit Modi	Director, Equity Research	+91 22 4254 2860	mohit.modi@crisil.com
Jiju Vidyadharan	Director, Funds & Fixed Income Research	+91 22 3342 8091	jiju.vidyadharan@crisil.com
Ajay D'Souza	Director, Industry Research	+91 22 3342 3567	ajay.dsouza@crisil.com
Ajay Srinivasan	Director, Industry Research	+91 22 3342 3530	ajay.srinivasan@crisil.com
Rahul Prithiani	Director, Industry Research	+91 22 3342 3574	rahul.prithiani@crisil.com

Business Development

Hani Jalan	Director, Capital Markets	+91 22 3342 3077	hani.jalan@crisil.com
Prosenjit Ghosh	Director, Industry & Customised Research	+91 22 3342 8008	prosenjit.ghosh@crisil.com

Business Development – Equity Research

Vikram Thirani – Associate Director
Email : vikram.thirani@crisil.com
Phone : +91 9820199188

Saurabh Sabharwal – Business Development Manager
Email : saurabh.sabharwal@crisil.com
Phone : +91 9650228684

Priyanka Murarka – Regional Manager
Email : priyanka.murarka@crisil.com
Phone : +91 9903060685

CRISIL RESEARCH

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- Largest team of economy and industry research analysts in India
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- Coverage on 86 industries: We provide analysis and forecast on key industry parameters including demand, supply, prices, investments and profitability, along with insightful opinions on emerging trends and impact of key events
- Research on sectors and clusters dominated by small and medium enterprises covering analysis of relative attractiveness, growth prospects and financial performance
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- Largest provider of fixed income valuations in India
- Provide valuation for more than ₹70 trillion (US$ 1,167billion) of Indian debt securities
- Sole provider of fixed income and hybrid indices to mutual funds and insurance companies; we maintain 37 standard indices and over 100 customised indices
- Ranking of Indian mutual fund schemes covering 73% of assets under management and ₹7.2 trillion (US$ 120 billion) by value
- Business review consultants to The Employees' Provident Fund Organisation (EPFO) and The National Pension System (NPS) Trust in monitoring performance of their fund managers

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Our Office

Ahmedabad
706, Venus Atlantis
Nr. Reliance Petrol Pump
Prahladnagar, Ahmedabad, India
Phone: +91 79 4024 4500
Fax: +91 79 2755 9863

Bengaluru
W-101, Sunrise Chambers,
22, Ulsoor Road,
Bengaluru - 560 042, India
Phone: +91 80 2558 0899
+91 80 2559 4802
Fax: +91 80 2559 4801

Chennai
Thapar House,
43/44, Montieth Road, Egmore,
Chennai - 600 008, India
Phone: +91 44 2854 6205/06
+91 44 2854 6093
Fax: +91 44 2854 7531

Gurgaon
Plot No. 46
Sector 44
Opp. PF Office
Gurgaon - 122 003, India
Phone: +91 124 6722 000

Hyderabad
3rd Floor, Uma Chambers
Plot No. 9&10, Nagarjuna Hills,
(Near Punjagutta Cross Road)
Hyderabad - 500 482, India
Phone: +91 40 2335 8103/05
Fax: +91 40 2335 7507

Kolkata
Horizon, Block 'B', 4th Floor
57 Chowringhee Road
Kolkata - 700 071, India
Phone: +91 33 2289 1949/50
Fax: +91 33 2283 0597

Pune
1187/17, Ghole Road,
Shivaji Nagar,
Pune - 411 005, India
Phone: +91 20 2553 9064/67
Fax: +91 20 4018 1930

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CRISIL Limited
CRISIL House, Central Avenue,
Hiranandani Business Park, Powai, Mumbai – 400076. India
Phone: +91 22 3342 3000 | Fax: +91 22 3342 8088
www.crisil.com

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