June 27, 2022

Wheels turn - albeit quickly, supportive macros indicate gains for domestic automobile space…

In our last update released in March 2022 (link), we had opined about resurfacing issues for the automobile sector largely on account of disruptions in the supply chain (chip availability) and increase in key commodity prices namely crude and metals amid ongoing geo-political crises. However, as we stand today, things have changed for the better. In the true sense wheels have turned benefitting the domestic automobile space. To start with, supply chain issues, remain largely resolved with management commentary suggesting improving chip availability and commodity prices mainly metals have corrected substantially amid resurfacing global growth concerns, Covid led clampdown in China, high inflation and consequent global centrals bank efforts to tame the same via interest rate hikes. Thus, with supporting macros at bay **we change our sectoral view to positive from neutral** earlier with our top bets in the auto OEM space being **M&M (BUY rating; revised target price: ₹ 1,315)** and **Maruti Suzuki (changing rating from HOLD to BUY; revised target price: ₹ 9,630)** while our top bets in ancillary space would be **Automotive Axles (BUY rating; TP: ₹ 2,140)** and **Minda Corporation (BUY rating; revised TP: ₹ 260).**

New launches, robust orderbook to support growth in PV space

The passenger vehicle segment is witnessing strong demand prospects with record waiting period across top selling models in the UV space. A vindication of the current trend is robust order-book at key OEMs. Maruti Suzuki's order-book is at ~3.2 lakh units as of April 2022, equivalent to two months of sales volume while the same for M&M is at >1.7 lakh units, equivalent to six months of sales volume. Consumer excitement is also upbeat with a series of exciting launches in the recent past and slew of impending launches namely **Scorpio-N from M&M, New Brezza from Maruti Suzuki, new SUV from Toyota- Suzuki partnership** among others.

Correction in metal prices, gross margin expansion in the offing

Metals are key raw material for the automobile space with steel & aluminium together constituting nearly ~50-65% of RM costs. In the recent past, domestic steel prices are down nearly 20% post restrictions placed on their exports while global aluminium prices are down nearly 25%+ amid muted demand from key markets like China. This softness of metal prices is a sign of relief and is likely to support profitability of the auto space in the near term. Over and above this, market leader in 2-W space i.e. Hero MotoCorp has announced a price hike up to ₹ 3,000 sensing healthy demand prospects with opportunity to realise better pricing and consequent operating margins.

Outperformance to continue, remain positive on PV & CV space

The Nifty Auto index has outperformed broader markets and is up ~4% YTD in CY22 vs. ~11% decline in Nifty. Other supportive factors for such outperformance include (i) pick up in pace of monsoons with cumulative as on date rainfall pegged at -7% of LPA, (ii) cut in excise duty on fuels (₹ 8/litre on petrol, ₹ 6/litre on diesel) in May 2022 thereby lowering running costs of vehicles and an impetus for new vehicle sales and (iii) decline in global crude prices (down ~10%+ from recent highs), a positive in terms of RM costs (crude derivatives- plastics) and expectations of further softness in fuel prices (petrol, diesel). **In the present uncertain global demand environment our top bets are largely domestic oriented business models which are capital efficient, have lean b/s, beneficiaries of strong underlying demand in passenger vehicle segment as well as cyclical recovery under way in CV space and are progressively transforming themselves amid changing technology landscape (i.e. electrification).**

Sector View: Positive

Top Picks in Auto OEM, Ancillary Space

Company	CMP (₹/share)	Old Target (₹/share)	New Target (₹/share)	Upside (%)
OEM Coverage				
Maruti Suzuki	8,365	8,545	9,630	15%
M&M	1,070	1,200	1,315	23%
Ancillary Coverage				
Automotive Axles	1,575	2,140	2,140	36%
Minda Corporation	185	315	260	41%

Nifty Auto index outperforming broader markets broadly on the back of

- Correction in metal prices with steel and aluminium down >=20% from peak and form major RM costs for the sector (~50-65%)
- Improving availability of semi-conductor chips
- Cut in excise duty on fuels (₹ 8/litre on petrol, ₹ 6/litre on diesel) in May 2022, thereby lowering running costs, an impetus for new sales
- Robust order book at key OEMs in PV space driven by need for personal mobility amid slew of exciting launches in UV space
- Cyclical recovery under way in commercial vehicle space driven by revival in public as well as private capex cycle
- Decline in crude prices (down ~10% +from recent highs), a positive in terms of RM cost (crude derivatives)

Key risks to our call

- Lower than anticipated sales volume growth over FY22-24E
- Supply chain issues limiting execution capabilities amid robust order-book

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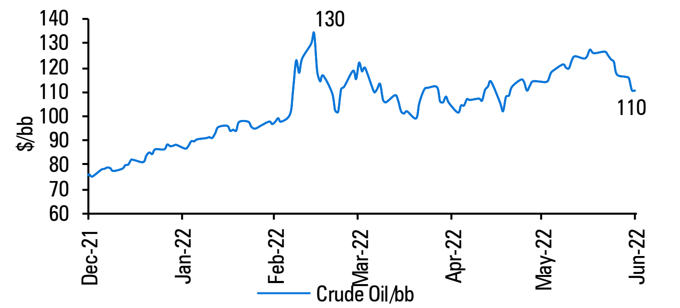
Commodity prices correcting meaningfully from recent peaks

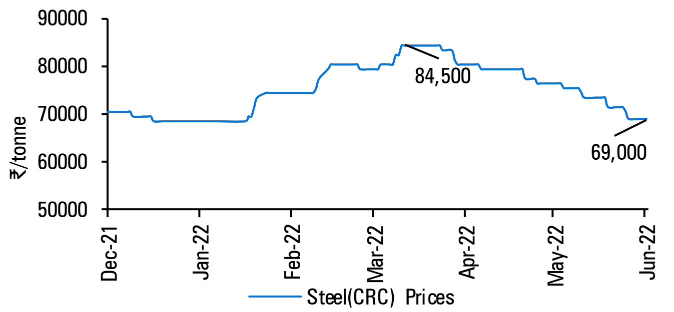
Steel, aluminium & plastics (crude derivatives) form a large chunk of raw material costs for manufacturing vehicles. Steel & aluminium together form ~50-65% of raw material cost, both of which have witnessed sharp correction from the peak. Aluminium is currently down to US$2,466/tonne vs. the peak of US$3,878/tonne in March 2022. Steel is currently down to ₹ 69,000/tonne vs. the peak of ₹ 84,500/tonne in April 2022. Brent crude oil has also corrected to US$110/barrel post skyrocketing to ~$130/bb levels in the past amid ongoing geopolitical crisis.

Exhibit 1: Brent Crude Oil



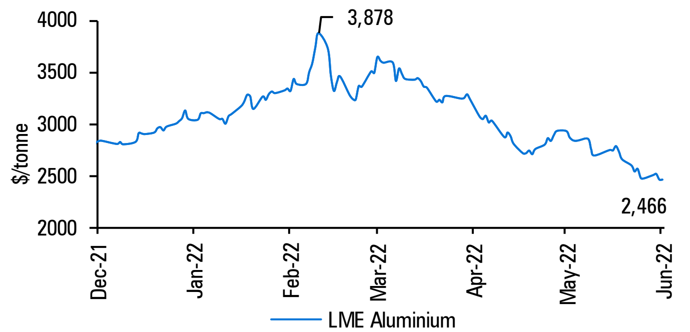
Source: Bloomberg, ICICI Direct Research

Exhibit 2: Steel (CRC) Price



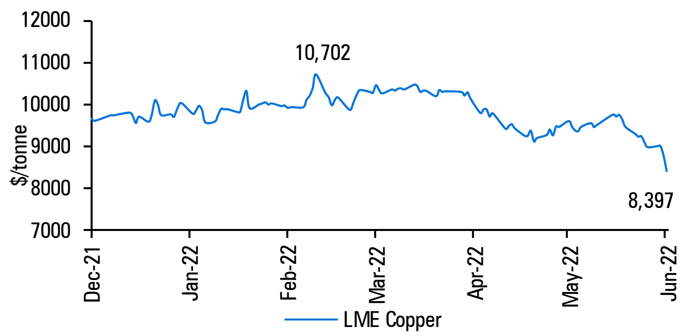
Source: Bloomberg, ICICI Direct Research

Exhibit 3: Aluminium price



Source: Bloomberg, ICICI Direct Research

Exhibit 4: Copper Price



Source: Bloomberg, ICICI Direct Research

Sectoral Growth Outlook: CV space to lead volume recovery

The automobile sector has been facing a lot of unsettling bumps on the road over the past few years. These included revised axle load norms for the CV space, mandatory long term third party insurance at the time of new vehicle purchase, change in emission norms from BS-IV to BS-VI, Covid-19 led volume disruptions, spike in fuel prices, shortages of semiconductor chip and commodity inflation led increase in vehicle prices. This has led to high double digit increase in vehicle prices over the past few years with consequent domestic sales volume declining ~30% from the past peak attained in FY19. However, as we stand today, on the back of low base, need for personal mobility as well as low penetration levels in the PV segment and cyclical recovery underway in the CV category, going forward we expect total domestic auto volumes to grow at a CAGR of 14.1% over FY22-24E. CV segment is expected to led the recovery with volumes in this space expected to grow at a CAGR of 15.2% over FY22-24E, PV space is expected to witness a volume CAGR of 14%, while 2-W space post bounce from a low base, is expected to grow single digit in FY24E. Marred by high base of FY21, tractor industry volumes are seen growing high single digit (~8%) in FY23E post declining ~6% in FY22 and thereafter grow 7% in FY24E. It will be broadly aided by favourable macroeconomic factors i.e. government support to rural incomes and infra development, high crop production & normal monsoons.

I-direct volume growth expectations

Domestic Volume Growth (YoY)					
Category	FY20	FY21	FY22	FY23E	FY24E
2-W	-17.8%	-13.2%	-10.9%	10.0%	6.0%
3-W	-9.2%	-65.5%	18.9%	20.0%	6.0%
PV	-17.8%	-2.3%	13.2%	16.0%	12.0%
CV	**-28.8%**	**-20.8%**	**26.0%**	**16.7%**	**13.7%**
-- M&HCV	-42.5%	-28.5%	49.7%	30.0%	20.0%
-- LCV	-20.1%	-17.2%	16.7%	10.0%	10.0%
Total Industry	**-18.8%**	**-15.3%**	**15.6%**	**16.4%**	**11.9%**
Tractors	**-9.9%**	**26.9%**	**-6.4%**	**8.0%**	**7.0%**

Top bets in Auto OEM Coverage Universe

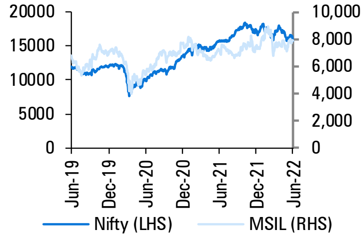
Maruti Suzuki (MSIL)

Maruti Suzuki (MSIL) is the market leader in the domestic passenger vehicle (PV) space with market share pegged at ~43% as of FY22 and popular models being Alto, WagonR, Swift, Brezza, Baleno, Ertiga, etc. among others. Also, the company's market share passenger car sub-segment is pegged at ~64%, SUV's is pegged at ~20% and vans is ~96%.

- MSIL's approach towards green mobility is through the CNG route wherein its penetration now at ~15% of its overall portfolio with highest ever sales at >2.3 lakh units as of FY22

We turn positive on MSIL amid robust order-book, underpenetrated PV category domestically, new launched & refreshes in the UV space with penchant to recapture the lost market share and greenfield expansion on the anvil. The company is also likely to benefit from recent appreciation of the rupee vs. JPY as well as correction in metal prices. Revising our estimates, we upgrade MSIL to **BUY** valuing it at ₹ 9,630 i.e. 30x PE on FY24E EPS.

Price Chart



Particulars

Particular	₹ crore
Market Capitalization	2,52,690
Total Debt (FY22P)	382
Cash & Invts. (FY22P)	42,136
EV	2,10,936
52 week H/L (₹)	9050 / 6537
Equity capital	₹ 151 Crore
Face value	₹ 5

Exhibit 5: Revised financial summary for MSIL

Key Financials	FY19	FY20	FY21	FY22P	5 year CAGR (FY17-22)	FY23E	FY24E	2 year CAGR (FY22-24E)
Net Sales	86,020.3	75,610.6	70,332.5	88,295.6	5.4%	1,07,207.6	1,22,360.4	17.7%
EBITDA	10,999.3	7,302.6	5,345.3	5,661.8	-11.4%	9,634.5	12,804.6	50.4%
EBITDA Margins (%)	12.8	9.7	7.6	6.4		9.0	10.5	
Net Profit	7,500.6	5,650.6	4,229.7	3,766.3	-12.5%	7,030.9	9,695.8	60.4%
EPS (₹)	248.3	187.1	140.0	124.7		232.7	321.0	
P/E	33.7	44.7	59.7	67.1		35.9	26.1	
RoNW (%)	16.3	11.7	8.2	7.0		11.9	14.7	
RoIC (%)	68.6	26.8	24.2	24.2		48.7	65.5	

Source: Company, ICICI Direct Research

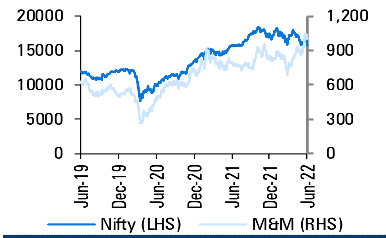
Mahindra & Mahindra (M&M)

M&M is a conglomerate with a presence in auto, IT, financial services, logistics, hospitality and real estate among others. At standalone level it is India's largest tractor manufacturer (~40% FY22 market share) and second largest CV, fourth largest PV maker (24.7%, 7.4% FY22 market share).

- Its recent launches in the PV segment viz. Thar, XUV 700 has gained positive customer response with current order book at 1.7 lakh+ units, equivalent to about six months of monthly sales run rate
- With a pipeline of interesting launches in the electric PV as well as LCV front, the company is steadily transforming amid change in technology landscape in the auto space. It plans to unveil its born electric strategy on August 15, 2022

We retain our positive view on M&M amid healthy demand prospects across its product profile, focus towards capital efficiency & EV proactiveness. We maintain **BUY** rating on M&M and now value it at ₹ 1,315 on an SoTP basis (10x FY24E standalone EV/EBITDA; 20% holdco discount to investments)

Price Chart



Particulars

Particular	Amount
Market Capitalization (₹ crore)	1,33,022
Total Debt (FY22P, ₹ crore)	6,490
Cash and Inv (FY22P, ₹ crore)	11,552
EV (₹ crore)	1,27,960
52 week H/L (₹)	1074 / 671
Equity capital (₹ crore) (FY22)	598.2
Face value (₹)	₹ 5

Exhibit 6: Revised financial summary for M&M

Particulars	FY19	FY20	FY21	FY22P	5 year CAGR (FY17-22)	FY23E	FY24E	2 year CAGR (FY22-24E)
Net Sales	53,614.0	45,487.8	45,041.0	57,431.0	5.4%	71,996.8	81,668.9	19.2%
EBITDA	6,639.6	5,798.0	6,506.1	7,042.9	9.3%	8,658.7	10,618.0	22.8%
EBITDA Margins (%)	12.4	12.7	14.4	12.3		12.0	13.0	
Net Profit	4,796.1	1,330.4	268.6	4,932.4	6.2%	5,677.9	7,119.9	20.1%
Adjusted Net Profit	4,818.6	2,190.4	942.5	5,097.5	9.6%	5,677.9	7,119.9	18.2%
EPS (₹)	40.2	11.2	2.3	41.3		47.6	59.7	
P/E	26.6	95.9	475.2	25.9		22.5	17.9	
RoNW (%)	14.1	6.4	2.7	13.1		13.1	14.7	
RoCE (%)	12.3	8.8	9.5	9.3		11.3	13.5	

Source: Company, ICICI Direct Research

Top bets in Auto Ancillary Coverage Universe

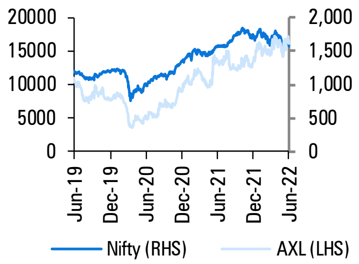
Automotive Axles

Automotive Axles (AAL) is the largest independent manufacturer of rear axle drive assemblies in India (primarily for CVs; M&HCV). Rear drive axles comprise ~60% of its topline with brakes share at ~20% and other parts comprising the rest. It counts all major CV OEMs as its clients with prominent names being Ashok Leyland, VECV, M&M among others.

- AAL is a beneficiary of the current cyclical recovery in the domestic CV space, especially the M&HCV domain. It has a healthy cash positive b/s with a consistent history of positive CFOs & FCFs

Its recent quarterly results were encouraging, with total operating income for Q4FY22 coming in at ₹ 552 crore, up 48% QoQ. PAT for the quarter was at ₹ 39 crore, nearly 2x QoQ. Notably, it expects domestic M&HCV segment to witness volume growth of ~30% in FY23E. Building in the positives, we expect sales, PAT to grow at a CAGR of 25%, 48%, respectively, in FY22-24E with consequent RoCE seen at ~25% in FY24E. We maintain our **BUY** rating on AAL valuing it at ₹ 2,140 i.e. 20x P/E on FY24E EPS.

Price Chart



Particulars

Particulars	₹ crore
Market capitalisation	2,378.3
Total Debt (FY22P)	14.6
Cash & Investment (FY22P)	97.3
EV (₹ crore)	2,295.5
52 week H/L (₹)	1,768 / 1,169
Equity capital (₹ crore)	15.1
Face value (₹)	1.0

Exhibit 7: Financial summary for AAL

Key Financials	FY19	FY20	FY21	FY22P	5 year CAGR (FY17-22)	FY23E	FY24E	2 year CAGR (FY22-24E)
Net Sales	1,939.0	952.0	905.6	1,490.6	4.9%	1,937.8	2,325.4	24.9%
EBITDA	229.0	93.3	65.8	134.7	3.4%	193.8	255.8	37.8%
EBITDA Margins (%)	11.8	9.8	7.3	9.0		10.0	11.0	
Net Profit	121.5	41.1	22.7	74.4	8.7%	116.5	161.7	47.5%
EPS (₹)	80.4	27.2	15.0	49.2		77.1	107.1	
P/E	19.6	57.8	104.7	32.0		20.4	14.7	
RoNW (%)	22.6	8.0	4.6	12.0		16.6	19.9	
RoCE (%)	29.9	10.1	5.2	15.5		21.5	25.8	

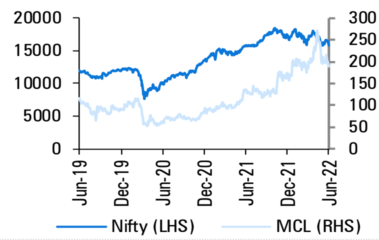
Source: Company, ICICI Direct Research

Minda Corporation

Minda Corporation (MCL) primarily serves domestic auto OEMs across two main verticals – mechatronics & aftermarket (safety & security, die-casting, starter motors, etc) and information & connected systems (wiring harnesses, instrument clusters). As on FY22, 2-W forms a large part of its sales at ~49% with CV, PV share of sales pegged at ~19%, ~18%, respectively. It has a largely EV immune product profile. Interestingly, it is already supplying its products to EV OEMs like Ola Electric, Ampere, Revolt among others and has also developed products exclusively for EVs viz. DC to DC converter, motor controller, telematics, battery charger, etc.

With robust order wins (₹ 5,930 crore lifetime orders- FY22; replacement & new business combined; EV order win at ₹ 952 crore) and penchant to grow ahead of industry (by 10-15%), we build ~24% sales CAGR in FY22-24E with RoCE and EBITDA margins expected to improve to ~20% and ~12%, respectively, by FY24E. It is currently trading at inexpensive valuations of ~14x PE on FY24E numbers and offers an attractive risk-reward play. We maintain our **BUY** rating to the stock valuing it at ₹ 260 i.e. 20x P/E on FY24E.

Price Chart



Particulars

Particulars	Amount
Market capitalisation (₹ crore)	4,418.7
Total Debt (FY22P, ₹ crore)	391.3
Cash & Inv. (FY22P, ₹ crore)	333.4
EV (₹ crore)	4,476.7
52 week H/L (₹)	287 / 104
Equity capital (₹ crore)	47.8
Face value (₹)	2.0

Exhibit 8: Revised financial summary for MCL

Key Financials	FY19	FY20	FY21	FY22P	5 year CAGR (FY17-22)	FY23E	FY24E	2 year CAGR (FY22-24E)
Net Sales	3,092.0	2,222.6	2,368.0	2,975.9	2.8%	3,980.3	4,577.3	24.0%
EBITDA	292.4	245.4	217.0	294.5	2.5%	457.7	558.4	37.7%
EBITDA Margins (%)	9.5	11.0	9.2	9.9		11.5	12.2	
Net Profit	169.2	(199.8)	52.8	191.8	-12.3%	239.0	312.3	27.6%
EPS (₹)	7.5	(8.8)	2.2	8.0		10.0	13.1	
P/E	24.8	(21.0)	83.7	23.0		18.5	14.1	
RoNW (%)	14.2	(20.5)	4.6	14.4		15.5	17.2	
RoCE (%)	10.8	10.5	7.5	10.5		17.0	19.8	

Source: Company, ICICI Direct Research

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