

March 16, 2020

## Uncertainty warrants focus on domestic businesses...

Domestic equity markets witnessed a sharp fall tracking the jitteriness in global equity markets over the spread of Covid-19 and sharp correction in crude prices. Domestically, the auto sector universe was no exception with a sharp price correction across our coverage companies. The correction was more profound for companies like Tata Motors, which have direct exposure to Chinese markets on the demand front (China constitutes ~18-20% of sales volume at JLR) and for companies like Motherson Sumi, Apollo Tyre, which have high presence outside India. Bajaj Auto, which realises significant sales volume from the export market (~40%), particularly from crude-oil dependent economies of Africa like Nigeria, was also severely impacted. The present correction has led us to retest our investment thesis and made us more conservative in our forward estimates. We believe the present correction is sort of overdone in most cases. However, in the **present turbulent scenario, we will stick to domestic oriented business models possessing healthy capital efficiency/high asset value.** Henceforth, in our coverage we **recommend BUY on Ashok Leyland, Bajaj Auto, Hero MotoCorp, M&M, Exide, Amara Raja and Goodyear India.** For the rest of our coverage universe, we largely recommend HOLD at this juncture.

**Recommend BUY** on domestic market oriented business models viz. **Ashok Leyland, Bajaj Auto, Hero MotoCorp, M&M, Exide, Amara Raja and Goodyear India**

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### Exhibit 1: Auto OEM & ancillary coverage universe summary

Company	Rating		Target Price		Corona Virus Impact	Crude Price Decline Impact	Remarks	
	Old	New	Old	New	(High/ Low/ Moderate)	(Negative / Positive/ No Impact)		
<b>Auto OEMs</b>	<b>CMP</b>							
Ashok Leyland	64	Hold	Buy	85	74	Low	No Impact	Largely domestic play. Incremental focus is on LCV exports. Impact limited to delay in demand recovery
Bajaj Auto	2,350	Hold	Buy	3,300	2,700	Moderate	Negative	Export constitutes ~40% of sales with oil dependent African region one of its key customers. Valuation comfort
Eicher Motors	17,000	Hold	Hold	19,750	18,365	Moderate	No Impact	Higher cc (650) interceptor series primarily meant for exports in the developed world
Escorts	645	Hold	Hold	810	720	Low	No Impact	Primarily domestic tractor and construction equipment play
Hero MotoCorp	1,800	Buy	Buy	2,800	2,225	Low	Positive	Primarily a domestic 2-W play. Exports a renewed focus
Maruti Suzuki	5,500	Sell	Reduce	5,850	5,100	Low	Positive	Domestic PV segment leader. Decline in petrol prices to stimulate conversions. Expensive valuations persist
M & M	425	Buy	Buy	680	550	Moderate	No Impact	Primarily domestic tractor and UV play. South Korea operations recovery may witness delay
Tata Motors	90	Hold	Hold	200	100	High	No Impact	JLR sales to be impacted; China constitutes ~20% of sales volume plus luxury car market to slow down in developed nations across EU & US
<b>Auto Ancillaries</b>								
Bharat Forge	365	Hold	Hold	465	385	Moderate	Negative	Delay in demand recovery in CV space to limit growth. Sales to global oil & gas exploration space an added negative
Bosch	11,200	Reduce	Reduce	12,850	10,285	Low	No Impact	Largely domestic play. Expensive valuations persist
Mahindra CIE	102	Hold	Hold	155	115	High	No Impact	Outside India constitutes 50%+ proportion of sales with varied geographical as well as client exposure
MM Forging	330	Hold	Hold	510	375	Moderate	No Impact	Exposure to global CV market (US class 8 trucks). Delay in recovery to weigh on growth prospects
Motherson Sumi	65	Hold	Hold	130	62	High	No Impact	Outside India constitutes ~88% of sales with varied geographical as well as client exposure.
Wabco	6,400	Hold	Hold	6,510	6,535	Low	No Impact	Largely domestic play. Open offer to support CMP
Gabriel	75	Hold	Hold	120	85	Low	No Impact	Largely domestic play. Exports at <5% of sales
<b>Battery Players</b>								
Amara Raja	575	Hold	Buy	760	700	Low	No Impact	Limited impact; largely domestic play
Exide	145	Buy	Buy	220	175	Low	No Impact	Limited impact; largely domestic play
<b>Tyre Companies</b>								
Apollo Tyres	100	Hold	Hold	165	113	Moderate	Positive	Demand concerns over replacement market ecosystem In India. Moreover, demand at Europe (~30% of sales) at risk
Balkrishna Inds	900	Hold	Hold	1,275	1,000	Moderate	Positive	Exports constitute ~80% of stake with healthy 50%+ exposure to EU. Growth to be impacted
Goodyear India	770	Buy	Buy	1,000	910	Low	Positive	Limited demand impact, limited benefits of crude decline due to significant share of trade purchases (~30%)
JK Tyre	50	Hold	Hold	85	55	Moderate	Positive	Demand concerns over replacement market ecosystem

Source: ICICI Direct Research

## Tata Motors

- Tata Motors' standalone operations (PV+CV) will have limited impact on account of Covid-19 largely pertaining to some delay in demand recovery and is mostly India centric
- Tata Motors' overseas arm i.e. JLR- the luxury car manufacturer is expected to be the hardest hit, particularly when Chinese markets were the new growth engine for the company and have been performing well since July 2019
- China constitutes ~20% of total JLR sales volume in 9MFY20 and reported an 85% decline in retail sales for February 2020. The recovery in China is expected to be modest, going forward. In the overseas markets of Europe and the US with the present situation of lockouts we expect sales for JLR to be very muted in March-April 2020
- With expansive capex plans under way, this muted demand scenario will meaningfully change the B/S parameters at Tata Motors and will challenge the FCF generation, going forward. This significantly erodes our margin of safety on the stock and, hence, calls for a steep target price correction. Consequently, we trim our estimates and assign a **HOLD** rating on Tata Motors with a revised target price of ₹ 100

## Bajaj Auto

- Bajaj Auto (BAL) is a leading 2-W & 3-W manufacturer domestically with exports constituting ~40% of sales by volume
- Growth in export sales was the key saviour for BAL amid a steep decline in domestic 2-W sales volume
- Going forward, we trim our estimates factoring in lower sales growth in the export markets more so given its high exposure to oil linked economies of Africa like Nigeria. Lower sales volumes also lead us to lower our margin estimates primarily tracking the perils of negative operating leverage
- Valuations, however, for Bajaj Auto are now in our comfort zone and provide a healthy margin of safety. Therefore, we upgrade it to **BUY** with a revised target price of ₹ 2700.

## Motherson Sumi

- Motherson Sumi is a global auto ancillary player with diverse exposure to geographies as well as global OEMs
- Outside India constitutes ~88% of sales on a consolidated basis. Key markets in Europe like Germany (~23% of sales) are its geographical hub
- In the scenario of de-acceleration of global GDP growth with consequent impact on global auto sales volume, the organic growth prospects will be limited. This will greatly hamper the ramp up at its new greenfield facilities that are yet to report healthy capital efficiency. This, coupled with currency risk, will weigh on valuations that Motherson commands. We have a cautious view on the stock and assign a **HOLD** rating with a revised target price of ₹ 62

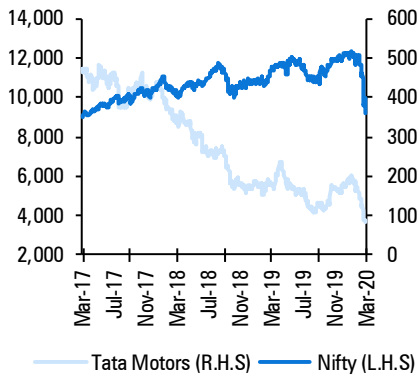
## Bharat Forge

- Bharat Forge is a leading forging player supplying forged metal to domestic and global markets in the CV, PV and industrial space
- In terms of export, it has sizeable exposure to US Class 8 trucks in the global CV segment and global oil & gas (including shale gas) space in the industrial segment. With lockouts surrounding the Covid-19, we expect the demand recovery to be delayed for the global CV space
- Moreover, current crude prices (US\$30/barrel) offer little incentive for exploration activity in the global oil & gas segment impacting Bharat Forge's demand prospects in the global industrial segment
- In the present muted demand scenario, the company is largely behind its major capex with focus on deleveraging its B/S. We assign a **HOLD** rating on the stock with a revised target price of ₹ 385

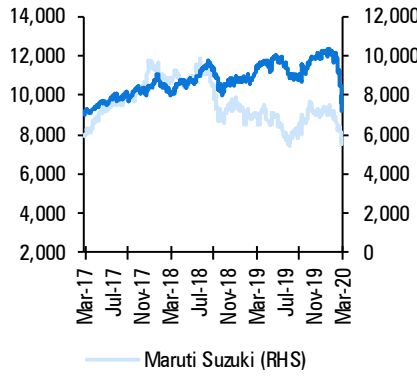
## Tyre companies

- Tyre companies per se will benefit from crude price decline as crude derivatives form a large portion of their raw material costs (carbon black and NTCF)
- A higher proportion of after-market/replacement sales (~60-70%) largely helps tyre companies in absorbing the raw material price decline thereby improving their financials. To put things into perspective, in the period of low crude prices i.e. around FY16 most of the tyre companies realised high double digit EBITDA margins (~14-17%) vs. the prevailing ~10-11% and consequent healthy return ratios (RoCE >~20%)
- However, we refrain from upgrading coverage companies like Apollo Tyre, JK Tyre due to levered B/S and likely disruption in the aftermarket ecosystem. Apollo Tyre is a leading tyre manufacturer with operations in India and Europe. India constitutes ~70% of sales by value with Europe comprising the rest at ~30%. ATL realises mid-double digit RoCE (~15%) in its domestic operations while the similar matrix is dismal in its overseas arm (~2-3%)
- Balkrishna Industries also fails to make our upgrade list despite healthy B/S given the export nature of its business model with bulk of exports to the European (~50%) and US (~15%) region wherein demand recovery may take a while post Covid-19 outbreak
- However, we retain our **BUY** rating on Goodyear India, which is an indirect play on farm mechanisation and has a largely India centric business model. The company also possess debt free B/S and a capital efficient business model

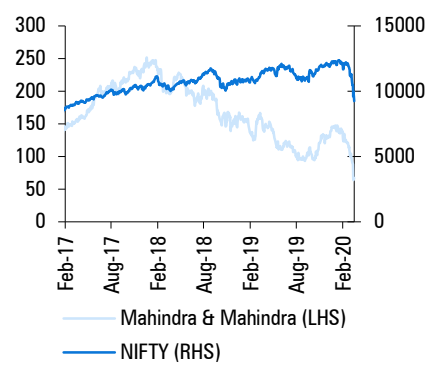
**Tata Motors price chart**



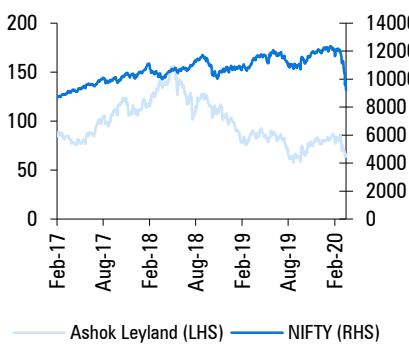
**Maruti Suzuki price chart**



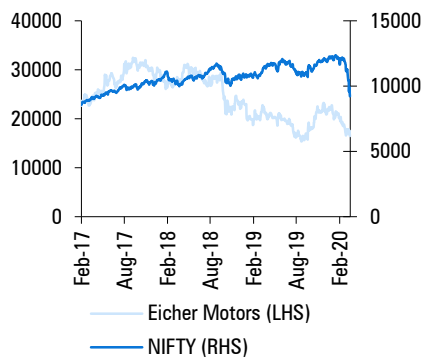
**Mahindra & Mahindra price chart**



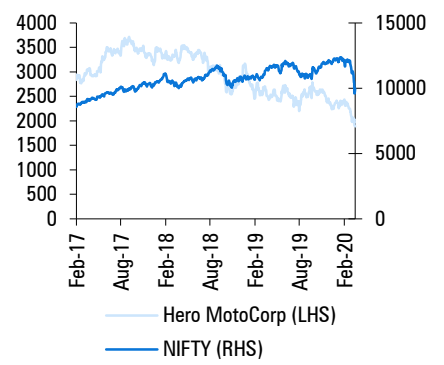
**Ashok Leyland price chart**



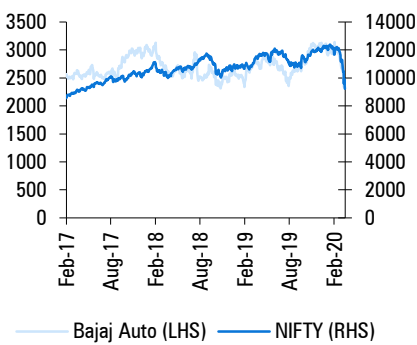
**Eicher Motors price chart**



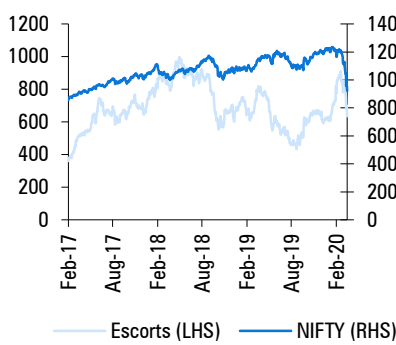
**Hero MotoCorp price chart**



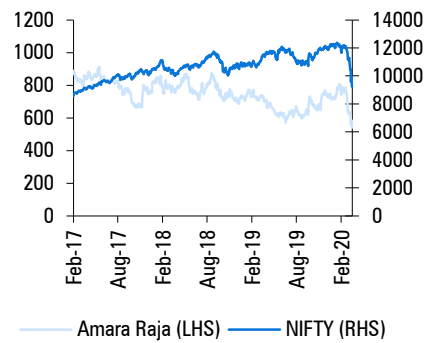
**Bajaj Auto price chart**



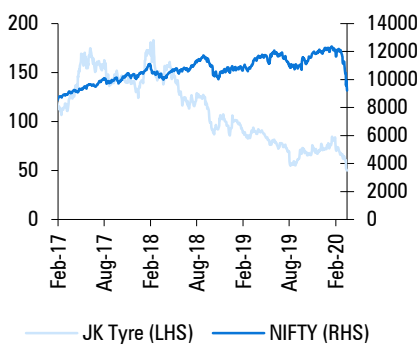
**Escorts price chart**



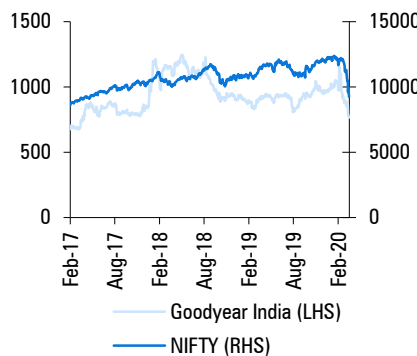
**Amara Raja price chart**



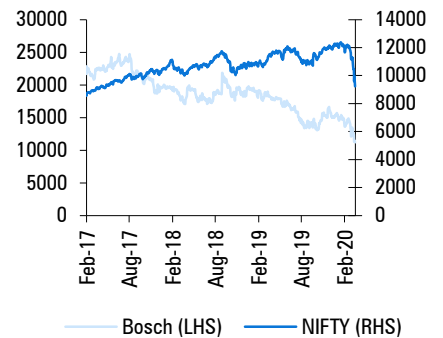
**JK Tyre price chart**



**Goodyear India price chart**



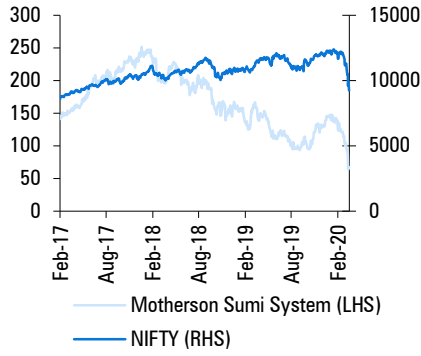
**Bosch price chart**



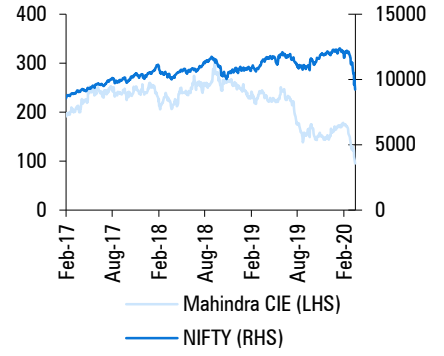
**Wabco price chart**



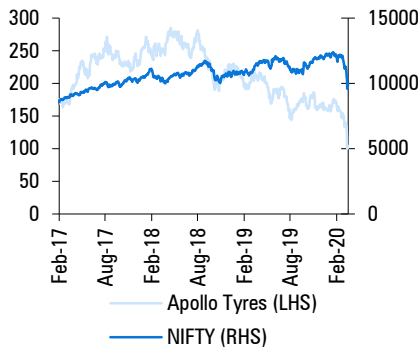
**Motherson Sumi price chart**



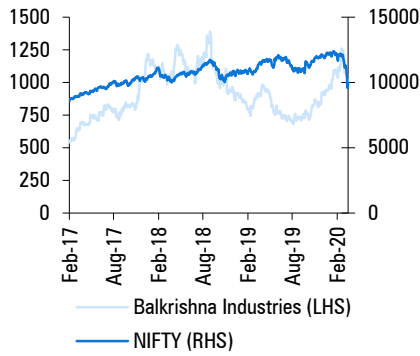
**Mahindra CIE price chart**



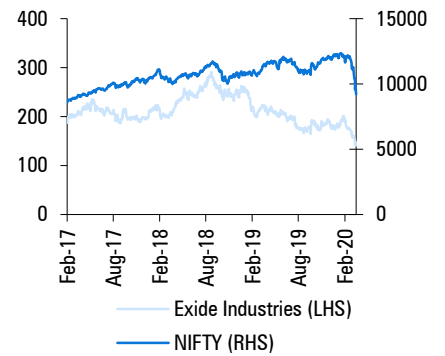
**Apollo Tyres price chart**



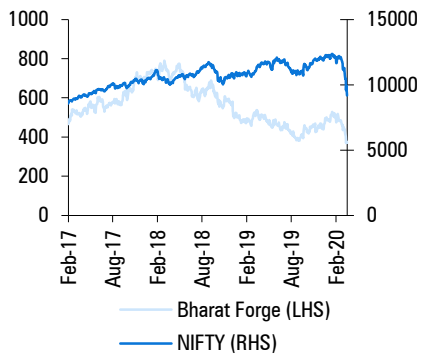
**Balkrishna Industries price chart**



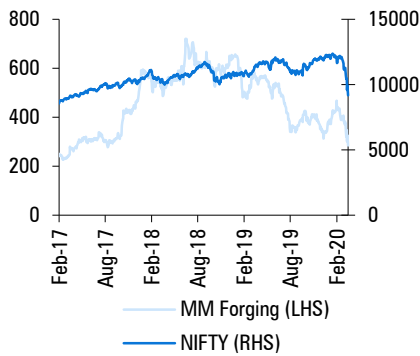
**Exide Industries price chart**



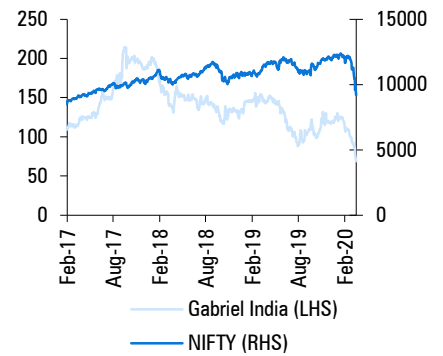
**Bharat Forge price chart**



**MM Forging price chart**



**Gabriel price chart**



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Buy: >15%;

Hold: -5% to 15%;

Reduce: -5% to -15%;

Sell: <-15%



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