Initiating Coverage

Automotive Axles Ltd.

March 31, 2022

RETAILRESEARCH

Automotive Axles Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Auto Ancillaries	Rs 1673	Buy in Rs 1665-1690 band & add more on dips to Rs 1490-1515 band	Rs 1808	Rs 1974	2 quarters

HDFC Scrip Code	AUTAXLEQNR
BSE Code	505010
NSE Code	AUTOAXLES
Bloomberg	ATXL IN
CMP Mar 30, 2022	1672.8
Equity Capital (Rs cr)	15.1
Face Value (Rs)	10
Equity Share O/S (cr)	1.5
Market Cap (Rs cr)	2528
Book Value (Rs)	372.2
Avg. 52 Wk Volumes	35000
52 Week High (Rs)	1700.0
52 Week Low (Rs)	945.0

Share holding Pattern % (Dec, 2021)	
Promoters	71.0
Institutions	14.9
Non Institutions	14.0
Total	100.0

* Refer at the end for explanation on Risk Ratings

Fundamental Research Analyst
Atul Karwa
atul.karwa@hdfcsec.com

Our Take:

Automotive Axles Ltd. (AAL) is the leader in CV axles and the second largest player in brakes after Brakes India. Automobile sales, especially the CV segment, have witnessed sharp slowdown for the last few years due to negative sentiments prevailing in the economy and reduced economic activity on account of the pandemic. With the impact of the pandemic gradually withering and incremental spending by the government towards infrastructure, CV demand is likely to increase. Implementation of the scrappage policy would also lift CV demand. The company has sufficient spare capacity to meet the increasing demand for the next few years. The management has guided for an EBITDA margin of 11.7-12.2% driven by softer commodity prices and better cost control.

AAL is a key beneficiary of the revival in economic activity and consequently the pick up in demand for M&HCV. The products manufactured by AAL are unlikely to be impacted by the thrust towards EV as they would still be required. Also AAL has capabilities in the electric vehicles domain (e-axle for heavy duty trucks).

Valuation & Recommendation:

AAL has undertaken cost control measures to drive higher profitability. We expect the AAL to report Revenues/EBIDTA/PAT growth of 28/37/66% CAGR over FY21-24E backed by robust recovery expected in the CV cycle over the next couple of years. AAL has continuous focus on working capital improvement and inventory optimisation and continuous focus on revenue improvement, new product development, operational excellence & cost optimisation as part of Mission 25 Strategy. AAL has embarked on Mission 25 strategy which focusses on growing revenues, enhance profitability, new business wins, operational excellence and customer value and is on track to achieve the stated goals. With higher profitability, RoE/RoCE are also expected to improve from the lows of FY21 to 15.3/21.0% by FY24E.

We believe investors can buy the stock in Rs 1665-1690 band and add on dips to Rs 1490-1515 band (22x FY24E EPS) for a base case fair value of Rs 1808 (26.5x FY24E EPS) and bull case fair value of Rs 1974 (29x FY24E EPS) over the next 2 quarters.

Financial Summary

Particulars (Rs cr)	Q3FY22	Q3FY21	YoY (%)	Q2FY22	QoQ (%)	FY21	FY22E	FY23E	FY24E
Net sales	374	272	*37.7*	309	*21.2*	906	1340	1635	1897
EBITDA	35	25	*37.2*	22	*57.7*	66	105	136	169
APAT	20	13	*50.3*	10	*95.3*	23	57	79	103
Diluted EPS (Rs)	13.1	8.7	*50.3*	6.7	*95.3*	15.0	37.6	52.4	68.2
RoE (%)						4.2	9.9	12.8	15.3
P/E (x)						111.3	44.5	31.9	24.5
EV/EBITDA (x)						37.5	23.7	18.3	14.7

(Source: Company, HDFC sec)

Q3FY22 Result update

AAL reported a healthy performance in Q3FY22 with total operating income for Q3FY22 coming in at Rs 374cr, up 21% QoQ, EBITDA coming in at Rs 35cr with margins at 9.3%, up 210 bps QoQ. AAL reported PAT of Rs 20cr, up 95% QoQ. Exports accounted for 8-10% of revenue in H1FY22 and the company is looking to increase it to 15-20% over the coming years. AAL is exporting to North America, South America and to China.

Key Triggers

Market leader in CV axles and 2nd largest in brakes

AAL has a dominant position in the product segments it caters to. It is the market leader among the independent axle manufacturers and second largest player in brakes. It has an estimated market share of ~35% in axles as well as brakes. It has been gaining market share in the axle and brakes segment driven by new product launches and business wins. AAL would be a standout beneficiary of rising demand for the M&HCV segment. AAL starts with an axle called 10X, which is a fixed 10X and up to 150 axle, which is about 55 ton to 60 ton, which is an extra heavy vehicle.

Improvement in CV sales to drive higher demand

Domestic Commercial vehicle (CV) sales, a barometer of economic activity, have been recovering as the macro factors improve. With economic activity picking up, cargo movement has been on a rise. This, coupled with replacement demand from fleet operators, is expected to support sales of CVs in the coming months. Industry estimates as many as 275,000-300,000 CVs in this category will be sold in the ongoing financial year.

In April last year, a government task force firmed up a roadmap for capital investments of Rs 111 lakh crore in infrastructure under the National Infrastructure Pipeline (NIP) over six years through FY25, pledging 71% of the expenditure for energy, roads, urban development and railways, and envisaging a key role for private investors. The Prime Minister subsequently announced to launch the Gati Shakti infrastructure plan, which will build upon the NIP by creating “an integrated framework” for infrastructure development across the country, which will ensure that various economic hubs are able to better utilise the investments on the sector being done by the government and private players.

Electric vehicles introduction not to have a major impact
As the technology improves, the initial cost of owning electric vehicle is coming down. The government aims to have EV sales accounting for 30% of private cars, 70% for commercial vehicles and 80% for two- and three-wheelers by 2030, as there is an immediate need to decarbonise the transport sector. Although there have been some orders for procurement of electric vehicles for public transportation by State Govts, mass adoption of technology is still at a preliminary stage for CV and is unlikely to disrupt the current scenario in a meaningful way.

The technology is most likely to be adopted for passenger vehicles first followed by public transportation vehicles and lastly to M&HCVs due to the high power requirement to pull huge loads. Even if the technology develops rapidly it will not have a major impact on AAL as only the combustion engine would be replaced by electric engine. The vehicles would still be requiring axles, suspension and brakes i.e. the parts manufactured by AAL. Also AAL has capabilities in the electric vehicles domain (e-axle for heavy duty trucks).

Scrappage policy will boost demand for CVs
Government funded vehicle scrappage policy was launched in Aug’21 to replace old vehicles with modern and new vehicles on Indian roads. According to the new policy, commercial vehicles aged >15 years and passenger vehicles aged >20 years will have to be mandatorily scrapped if they do not pass the fitness and emission tests. The policy does not treat a vehicle as scrap just because of its age, but considers other

factors such as quality of brakes, engine performance and others. The objective is to phase out old cars, reduce urban pollution levels and stimulate automotive sales, which continues to record slowdown amid India's post-COVID recovery phase. Additionally, the vehicle scrappage policy is also said to be a part of a larger stimulus package majorly requested by OEMs to stir their demand.

The policy will likely result in the following projected gains:

- 30% boost for the Indian automobile industry, from the current Rs. 4.5 lakhcr (US$ 61.46bn) turnover to Rs. 10 lakhcr (US$ 136.59bn) over the coming years
- Export component of Rs. 1.45 lakhcr (US$ 19.81bn) in the current turnover is likely to go up to Rs. 3 lakhcr (US$ 40.98bn)
- Decrease India's huge Rs. 10 lakhcr (US$ 136.59bn) crude import bill
- Attract new investments of ~Rs. 10,000cr (US$ 1.37bn) and create as many as 35,000 jobs

Several countries including the US, Germany, Canada and China have introduced vehicle scrappage policies to boost their respective automotive industries and curtail vehicular pollution. This is likely to drive demand for newer CVs in the coming years.

Expanded capacity to benefit during CV revival

AAL expanded its axles and brakes capacity in FY20 at its Mysore plant. Post the commissioning, its brakes capacity has increased to 14.4 lakh per annum and axle capacity to 21.2 lakh per annum. The expanded capacity would enable the company to be ready for the expected increase in demand as the economic cycle is expected to improve in the coming years. The Axle assembly plant has robotic paint shop & is Industry 4.0 enabled. Also the implementation of scrappage policy is likely to drive higher demand for commercial vehicles. With sufficient capacity available, the company does not have any expansion plan in the near future.

Suspensions to provide incremental revenue per vehicle

AAL introduced slipper type suspension in 2019. However, due to the slowdown and the pandemic the sales of the product failed to pick up meaningfully. Slipper type suspension weigh 80-100 kgs lesser than the currently used bell crank suspension and provide better comfort and improvement in fuel efficiency. It also reduces tyre wear thereby increasing the life of the tyre from ~40,000 kms to ~120,000 kms. Although the initial cost is higher the overall life cycle cost reduces for the customer. However, due to material cost inflation and economic slowdown, OEMs are not willing to pass on the increased cost. We believe, suspensions could add significantly to content per vehicle for AAL. The company expects suspensions to contribute ~5% of total revenues in the next 3-4 years.

Strong parentage and client base

AAL is a joint venture of Arvin Meritor Inc., USA (formerly the automotive division of Rockwell International Corporation), a Fortune 500 company (35.5% stake) , and the Kalyani Group (35.5% stake). Products manufactured at AAL are based on technology provided by Arvin

Meritor Inc., USA, through Meritor HVS (India) Ltd. and more than 90% of the sales are routed through Meritor HVS. AAL's domestic OEM customers include Ashok Leyland, Daimler India, Man Trucks, Mahindra & Mahindra, Tata Motors, Volvo Eicher, Asia Motor Works and Indian Army, among others. AAL also exports its products indirectly through Meritor HVS India Ltd. to various countries including the US, France, Italy, China and Brazil. Ashok Leyland is the largest customer of AAL accounting for over 50% of revenues.
At the parent level, Cummins Inc. has acquired Meritor Inc. valuing Meritor Inc. at US$3.7 billion. Cummins Inc. is now expected to be the new co-promoter in AAL.

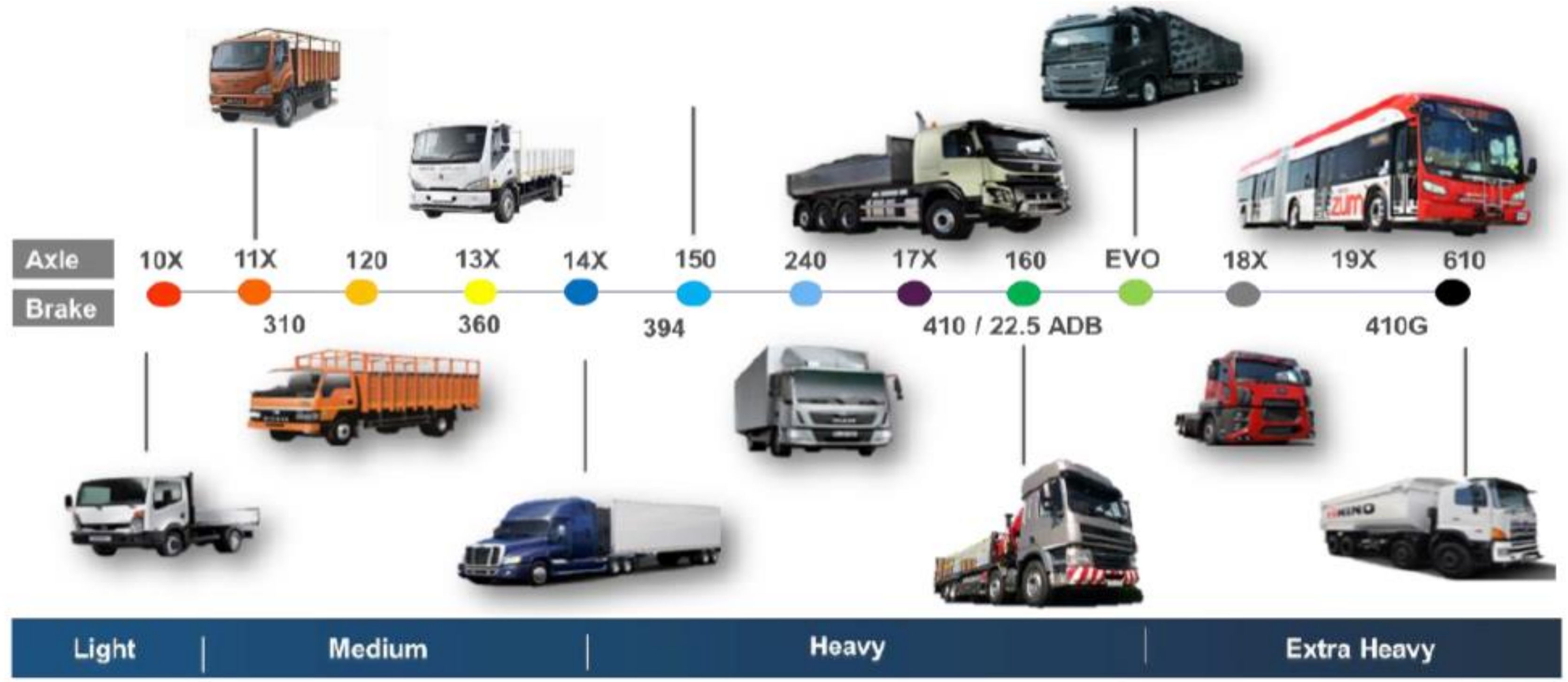
Diverse end markets

Major customers

(Source: Company, HDFCsec)

AAL is the largest manufacturer of rear drive axle assemblies for CV in India. Its product range includes wide range of axles catering to trucks, tippers, tractor trailers and other off-highway vehicles. In addition to axles it also manufactures and supplies drum and disk brakes assemblies for trucks, trailers, buses and coaches.

Most comprehensive Axle & Brake offerings



(Source: Company, HDFCsec)

Risks & Concerns

Exposed to cyclicality of CV segment

The company remains exposed to the cyclicality in the M&HCV industry. New CV sales have slowed down significantly post the pandemic due to the economic slowdown as transporters are not able to fully utilise their existing capacities.

Client concentration risks

The company is highly dependent on Ashok Leyland (accounts for over 50% revenues). However, a healthy market share and long-term association with Ashok Leyland provides comfort.

Dedicated Freight corridors

Construction of dedicated freight corridors in the eastern and western part of India could reduce the requirement of CV as faster and cheaper movement of goods would be possible.

Competition from global MNCs

High growth in the CV segment led to many MNCs setting up shop in India increasing the competitive intensity. International players like American Axles & Manufacturing Inc. and Dana Holding Corporation are present in the domestic market. Further ADR Axles India Pvt. Ltd., a fully-owned subsidiary of ADR Axles of Italy, entered the Indian market in FY18.

Company Background:

Established in 1981, Automotive Axles Limited (AAL) is a joint venture of Kalyani Group and Meritor Inc., USA (formally the automotive division of Rockwell International Corporation). AAL is currently the largest independent manufacturer of rear drive axle assemblies for CVs (primarily M&HCVs) in India. Its product portfolio includes a wide range of axles catering to haulage trucks, tippers, tractor trailers and other off highway vehicles used for special purposes. The company also supplies drum and disk brake assemblies for trucks, trailers, buses and coaches and is the second largest brake manufacturer in India after Brakes India Private Limited. With manufacturing plants at Mysore, Pantnagar, Jamshedpur and Hosur, the company supplies its components to customers across India as well as in international markets.

AAL's products are based on technology provided by Meritor. The technology transfer by Meritor is routed through its 51% subsidiary in India – Meritor HVS (India) Limited (MHVSIL). MHVSIL is also responsible for customer sourcing, interaction and marketing for AAL, with almost its entire domestic sales routed through MHVSIL. AAL's export sales are also routed through the Meritor Group globally. AAL manufactures and sells axles, components, brake components and sub-assemblies to MHVSIL, which, in turn, sells to the end customer.

AAL's domestic OEM customers include Ashok Leyland Limited (ALL), Daimler India Commercial Vehicles Private Limited (DI), Man Trucks India Private Limited (MT), Mahindra & Mahindra Limited (M&M), Tata Motors Limited (TML), Volvo Eicher Commercial Vehicles Limited (VE), Asia Motor Works Limited (AMW), and Indian Army, among others.

Financials

Income Statement

(Rs cr)	FY20	FY21	FY22E	FY23E	FY24E
Net Revenues	**952**	**906**	**1340**	**1635**	**1897**
Growth (%)	***-50.9***	***-4.9***	***48.0***	***22.0***	***16.0***
Operating Expenses	859	840	1236	1499	1728
EBITDA	**93**	**66**	**105**	**136**	**169**
Growth (%)	***-59.3***	***-29.4***	***58.8***	***29.8***	***24.4***
EBITDA Margin (%)	***9.8***	***7.3***	***7.8***	***8.3***	***8.9***
Depreciation	37	36	35	37	40
Other Income	8	7	11	11	13
EBIT	**64**	**37**	**80**	**110**	**142**
Interest expenses	2	3	4	4	4
Exceptional items	-2	-4	0	0	0
PBT	**60**	**30**	**76**	**106**	**138**
Tax	19	7	19	27	35
PAT	**41**	**23**	**57**	**79**	**103**
Adj. PAT	**41**	**23**	**57**	**79**	**103**
Growth (%)	***-66.2***	***-44.8***	***150.2***	***39.3***	***30.2***
EPS	27.2	15.0	37.6	52.4	68.2

Balance Sheet

As at March (Rs cr)	FY20	FY21	FY22E	FY23E	FY24E
SOURCE OF FUNDS					
Share Capital	15	15	15	15	15
Reserves	517	539	575	626	692
Shareholders' Funds	**532**	**554**	**590**	**641**	**707**
Borrowings	19	15	10	6	2
Net Deferred Taxes	-10	-8	-8	-8	-8
Other Non-curr. Liab.	11	9	13	16	19
Total Source of Funds	**551**	**570**	**606**	**656**	**720**
APPLICATION OF FUNDS					
Net Block & Goodwill	255	245	266	278	291
CWIP	24	32	16	12	9
Investments	0	12	27	45	65
Other Non-Curr. Assets	30	25	42	51	59
Total Non-Current Assets	**309**	**315**	**351**	**386**	**424**
Inventories	156	201	231	260	286
Trade Receivables	123	282	202	224	234
Cash & Equivalents	74	73	57	46	42
Other Current Assets	57	66	77	90	104
Total Current Assets	**409**	**621**	**567**	**619**	**665**
Trade Payables	115	290	239	269	286
Current Liab & Provisions	53	76	73	81	83
Total Current Liabilities	**167**	**367**	**312**	**349**	**369**
Net Current Assets	**242**	**255**	**255**	**270**	**296**
Total Application of Funds	**551**	**570**	**606**	**656**	**720**

Cash Flow Statement

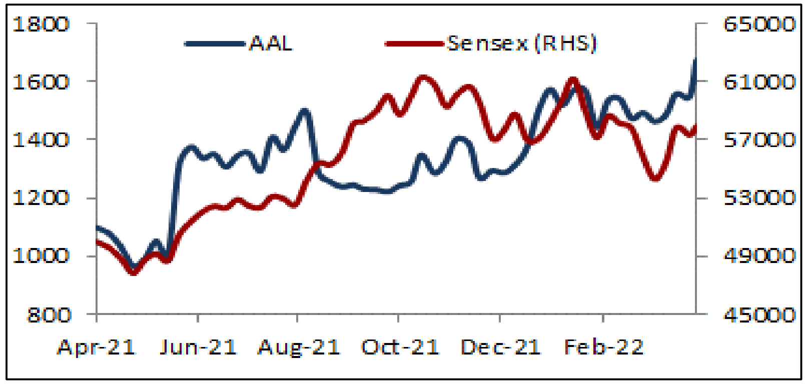
(Rs cr)	FY20	FY21	FY22E	FY23E	FY24E
PBT	60	30	76	106	138
Non-operating & EO items	0	2	-12	-6	-5
Interest Expenses	37	36	35	37	40
Depreciation	2	3	4	4	4
Working Capital Change	114	-13	-17	-26	-31
Tax Paid	-15	-9	-19	-27	-35
OPERATING CASH FLOW (a)	**198**	**49**	**67**	**89**	**111**
Capex	-62	-34	-40	-45	-50
Free Cash Flow	136	14	27	44	61
Investments	0	-12	-15	-18	-20
Non-operating income	3	7	0	0	0
INVESTING CASH FLOW (b)	**-59**	**-40**	**-55**	**-63**	**-70**
Debt Issuance / (Repaid)	-50	-4	-4	-4	-4
Interest Expenses	-7	-3	-4	-4	-4
FCFE	82	2	4	18	32
Share Capital Issuance	0	0	0	0	0
Dividend	-46	-1	-20	-28	-37
Others	-2	-2	0	0	0
FINANCING CASH FLOW (c)	**-105**	**-10**	**-28**	**-36**	**-45**
NET CASH FLOW (a+b+c)	**34**	**-1**	**-16**	**-11**	**-5**

Key Ratios

	FY20	FY21	FY22E	FY23E	FY24E
Profitability Ratios (%)					
EBITDA Margin	9.8	7.3	7.8	8.3	8.9
EBIT Margin	6.7	4.1	6.0	6.7	7.5
APAT Margin	4.3	2.5	4.2	4.8	5.4
RoE	7.7	4.2	9.9	12.8	15.3
RoCE	11.0	6.6	13.6	17.6	21.0
Solvency Ratio (x)					
Net Debt/EBITDA	-0.6	-0.9	-0.4	-0.3	-0.2
Net D/E	-0.1	-0.1	-0.1	-0.1	-0.1
PER SHARE DATA (Rs)					
EPS	27.2	15.0	37.6	52.4	68.2
CEPS	51.9	38.9	61.1	77.0	94.5
BV	352.0	366.7	390.7	424.3	467.9
Dividend	6.8	4.5	11.3	15.7	20.4
Turnover Ratios (days)					
Inventory	47	114	55	50	45
Debtor	66	87	68	63	60
Creditors	49	126	70	65	60
VALUATION (x)					
P/E	61.5	111.3	44.5	31.9	24.5
P/BV	4.8	4.6	4.3	3.9	3.6
EV/EBITDA	26.5	37.5	23.7	18.3	14.7
EV/Revenues	2.6	2.7	1.9	1.5	1.3
Dividend Yield (%)	0.4	0.3	0.7	0.9	1.2
Dividend Payout (%)	25.0	29.9	30.0	30.0	30.0

(Source: Company, HDFC sec)

Price chart



HDFC Sec Retail Research Rating description

Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. This stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Yellow Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicality of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.

HDFC securities Limited, I Think Techno Campus, Building - B, "Alpha", Office Floor 8, Near Kanjurmarg Station, Opp. Crompton Greaves, Kanjurmarg (East), Mumbai 400 042 Phone: (022) 3075 3400 Fax: (022) 2496 5066

Compliance Officer: Binkle R. Oza Email: complianceofficer@hdfcsec.com Phone: (022) 3045 3600

HDFC Securities Limited, SEBI Reg. No.: NSE, BSE, MSEI, MCX: INZ000186937; AMFI Reg. No. ARN: 13549; PFRDA Reg. No. POP: 11092018; IRDA Corporate Agent License No.: CA0062; SEBI Research Analyst Reg. No.: INH000002475; SEBI Investment Adviser Reg. No.: INA000011538; CIN - U67120MH2000PLC152193