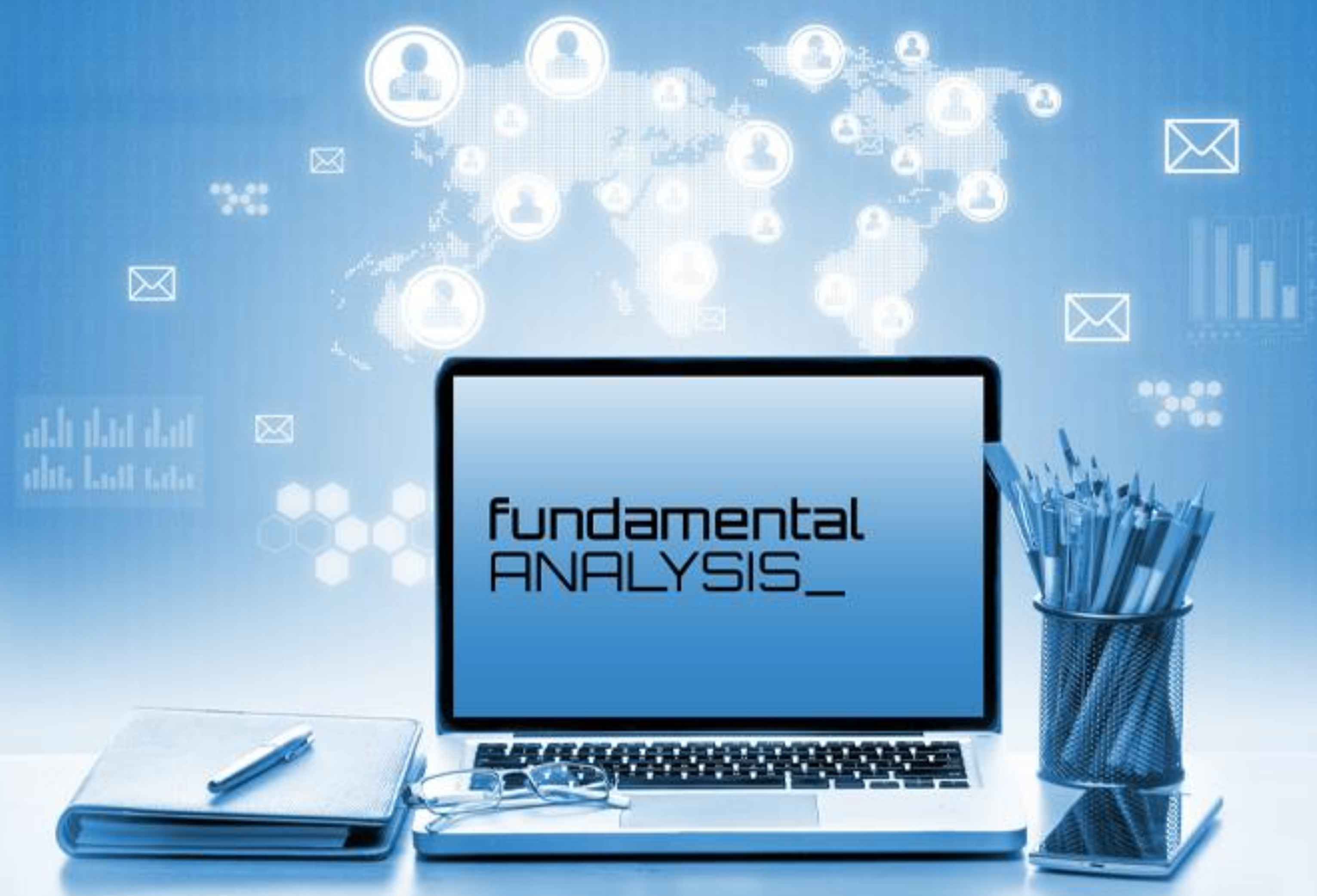
Stock Update

Automotive Axles Ltd.

Nov 13, 2023



RETAILRESEARCH

Automotive Axles Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Auto Ancillaries	Rs 2352	Buy in Rs 2330-2375 band & add more on dips in Rs 2070-2110 band	Rs 2548	Rs 2758	2-3 quarters

HDFC Scrip Code	AUTAXLEQNR
BSE Code	505010
NSE Code	AUTOAXLES
Bloomberg	ATXL IN
CMP Nov 12, 2023	2352.0
Equity Capital (Rs cr)	15.1
Face Value (Rs)	10
Equity Share O/S (cr)	1.5
Market Cap (Rs cr)	3554
Book Value (Rs)	525.0
Avg. 52 Wk Volumes	25,000
52 Week High (Rs)	2690.0
52 Week Low (Rs)	1870.6

Share holding Pattern % (Sep, 2023)	
Promoters	71.0
Institutions	12.7
Non Institutions	16.3
Total	100.0

HDFCsec Retail research stock rating meter

for details about the ratings, refer at the end of the report

* Refer at the end for explanation on Risk Ratings

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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 strong revival in FY23 and expected to rise 9-11% in FY24. Increase in infrastructure budget by the Govt. is likely to drive higher demand for CVs in the coming years. 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. Softening of raw material prices is also likely to benefit the company in expanding its margins.

AAL is a key beneficiary of the revival in economic activity and consequently the pickup 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:

We expect the AAL to report Revenues/EBIDTA/PAT growth of 11/14/18% CAGR over FY23-25E backed by robust growth in CV over the next couple of years. We believe investors can buy the stock in Rs 2330-2375 band and add on dips in Rs 2070-2110 band (14x FY25E EPS) for a base case fair value of Rs 2548 (17x FY25E EPS) and bull case fair value of Rs 2758 (18.5x FY25E EPS) over the next 2-3 quarters.

Financial Summary

Particulars (Rs cr)	Q2FY24	Q2FY23	YoY (%)	Q1FY24	QoQ (%)	FY22	FY23	FY24E	FY25E
Net sales	584	475	*23.1*	532	*9.9*	1491	2324	2593	2860
EBITDA	66	50	*30.9*	59	*12.6*	135	257	293	335
APAT	45	30	*49.6*	38	*19.2*	74	162	195	226
Diluted EPS (Rs)	29.8	19.9	*49.6*	25.0	*19.2*	49.2	107.2	129.3	149.5
RoE (%)						12.7	23.5	23.6	23.1
P/E (x)						47.7	21.9	18.1	15.7
EV/EBITDA (x)						25.8	13.6	11.9	10.4

(Source: Company, HDFC sec)

Q2FY24 Result update

AAL reported healthy numbers for Q2FY24 with total operating income increasing by 23% YoY to Rs 584cr, mainly driven by increased volumes. EBITDA increased 31% YoY to Rs 66cr while margin expanded 67bps to 11.3%. AAL reported PAT of Rs 45cr against Rs 30cr in Q2FY23.

Key Triggers

Market leader in CV axles and 2nd largest in brakes

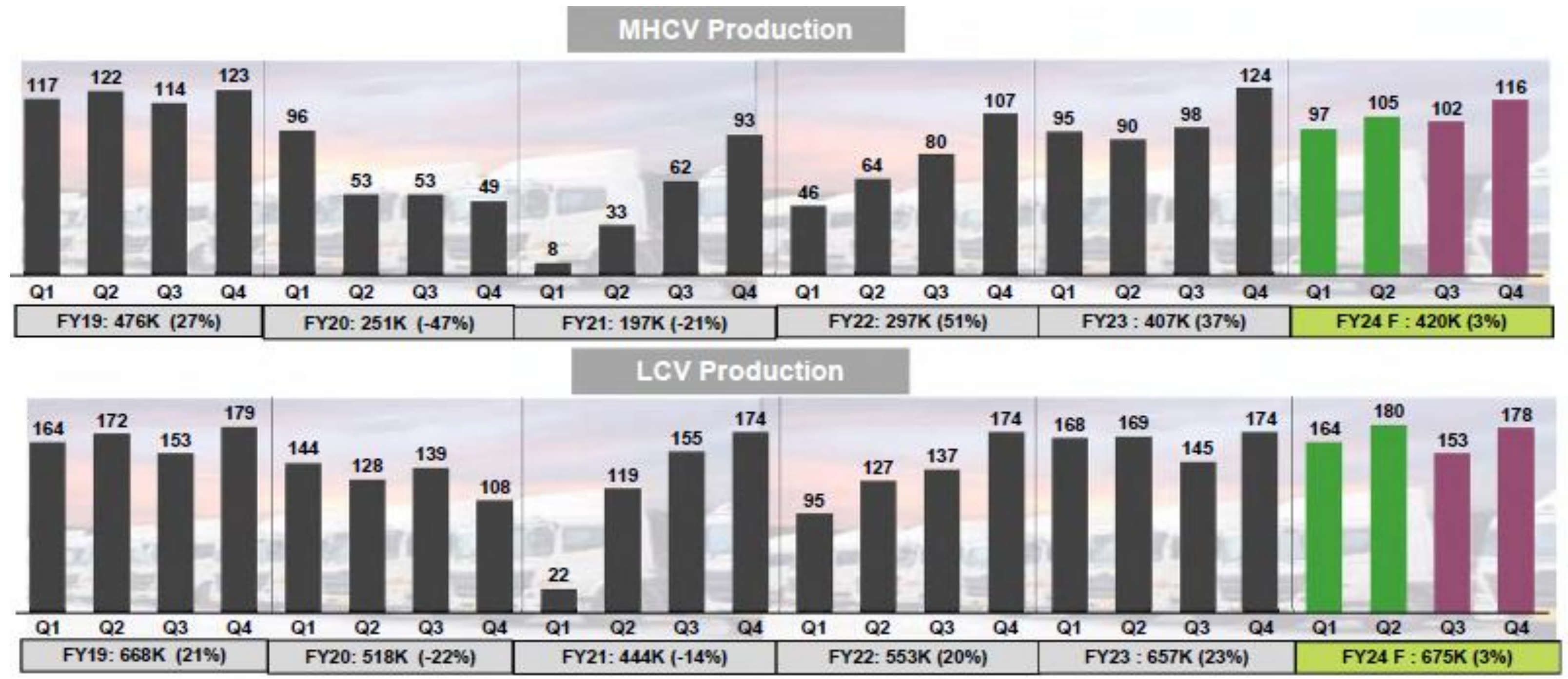
AAL has a dominant position in the product segments it caters to. It is the market leader among the independent axle manufacturers and second largest player in brakes. It has an estimated market share of ~35% in axles as well as brakes. It has been gaining market share in the axle and brakes segment 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. AAL aims to grow its market share in FY24 by 5-8% over the previous FY. Although the number of M&HCVs sold is still below the FY19 numbers, in terms of tonnage the industry has crossed the equivalent number of FY19. Also AAL has gained market share in domestic markets over the past 5 years, its exports have also grown at a fast pace.

Domestic CV sales to continue growth momentum

The commercial vehicle industry in India recorded a 2% year-in-year growth to 4.65 lakh units during April-September 2023 period. This comes on a high base of the first half of last fiscal year when the segment recorded 40% growth owing to the post-pandemic recovery. Increased allocation to infrastructure spending in the Union Budget is likely to provide support to CV demand. The Union Budget proposed to increase capital expenditure spending by 33% to Rs 10 lakh crore, focusing on augmenting core infrastructure assets, including roads, railways, airports and logistics. MHCV sale volumes is expected to grow faster than LCVs at 13-15% in FY24, but are expected to exceed pre-pandemic sale volumes in FY25.

With the latest World Economic Outlook report forecasting global inflation to decline steadily, from 8.7% in 2022 to 6.9% in 2023 and 5.8% in 2024- driven by tighter monetary policy and lower commodity prices, the overall economic activity is expected to pick up- which is likely to result in an increase in CV exports from India. Industry experts suggest that the CV industry, which is often referred to as the backbone of the national economy, is expected to record the peak sales in FY24.

CV production trend



US Class-8 truck orders remain strong

With 2024 orderboards open, fleets placed the highest number of Class 8 bookings this year in September. Preliminary US Class 8 net orders were 36,800 units, up 67% over August. Class 8 sales year-to-date were up 12.9% to 202,335 units, compared with 179,247 at this time in 2022. According to FTR Transportation Intelligence, Class 8 orders exceeded expectations, while builds came in lower than forecasted. The 2023 forecast moved slightly lower as OEMs struggled to meet production schedules. The Class 8 forecast eased by 2,700 units in 2023 while there was no change for 2024.Though Class 8 truck production will likely decline by around 20% next year, 2025 and 2026 should be strong years for truck demand as the industry prepares for the implementation of the 2027 emissions regulations.

Stricter emission regulations by US could drive higher Class-8 truck sales

US Environmental Protection Agency (EPA) has passed stricter emission control norms for heavy-duty vehicles starting in model year 2027. The regulation, part of the EPA's Clean Trucks Plan, tightens emission limits from 200 mg/bhp-hr for all diesel engines covered under the rule to 35 mg/bhp-hr for Otto-cycle and Class 4–5 diesel trucks and 50 mg/bhp-hr for Class 6–8 diesel trucks. The new rules could result in higher sales of heavy vehicles in the coming years as OEMs start to replace their fleets.

Strong parentage and client base

AAL was a joint venture of Arvin Meritor Inc., USA (35.5% stake), and the Kalyani Group (35.5% stake). Post the acquisition of Meritor by Cummins, AAL has become indirect JV partner of Cummins. 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.

Diverse end markets

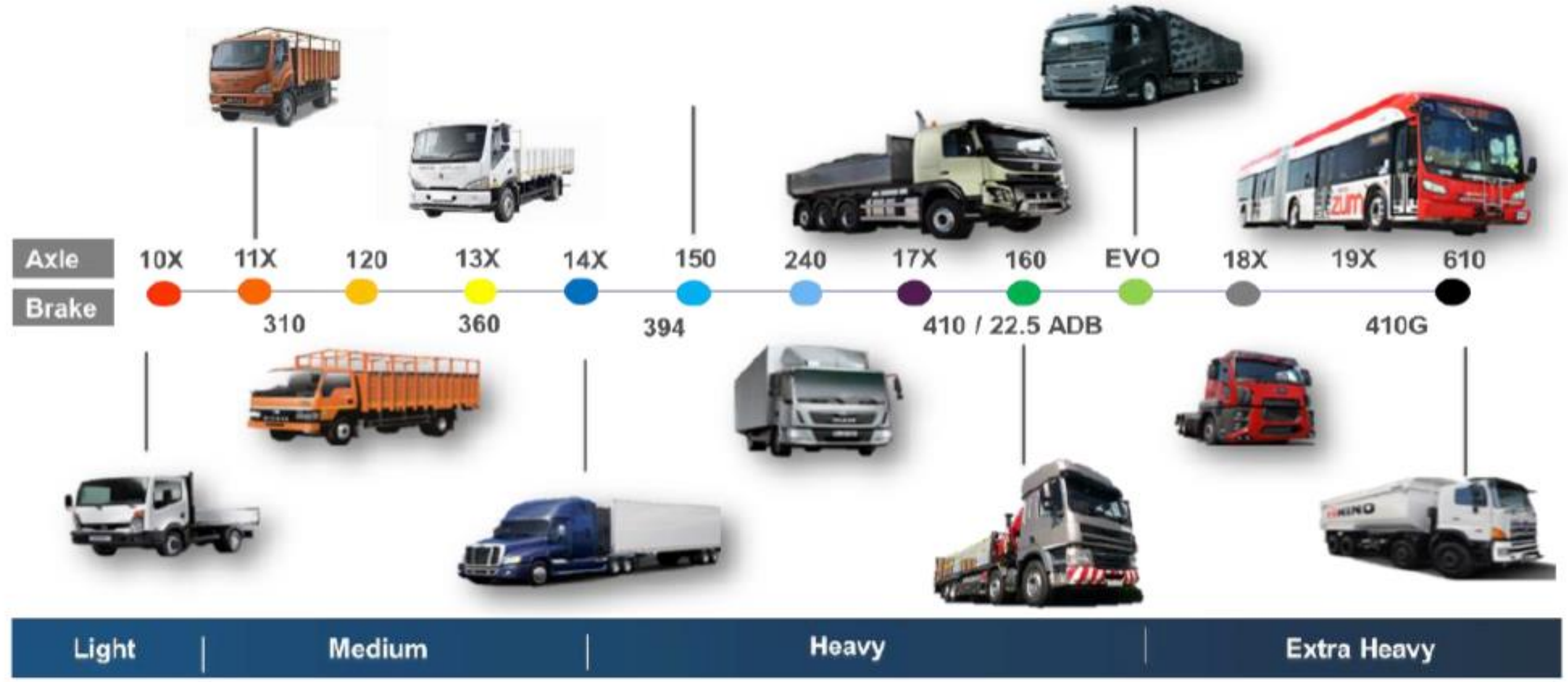
Major customers

ASHOK LEYLAND Aapki Jeet. Hamari Jeet.
TATA
Mahindra
DAIMLER Daimler India Commercial Vehicles Pvt. Ltd.
SML ISUZU
VE COMMERCIAL VEHICLES A VOLVO GROUP AND EICHER MOTORS JOINT VENTURE
BHARAT FORGE
KALYANI
VOLVO
CAT
bemI NEW FRONTIERS. NEW DREAMS
Godrej
CARGOTEC

(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)

Acquisition of Meritor by Cummins could benefit AAL

Cummins has completed the acquisition of Meritor in Oct'22. Meritor Inc is the parent company of Meritor Heavy Vehicle Systems (MHVS), which has a 35.52% stake in Automotive Axles. Cummins is a global supplier of drivetrains, mobility, braking, aftermarket and electric powertrain solutions to commercial vehicle and industrial markets. Cummins acquired Meritor Inc. to primarily acquire e-axle capabilities developed by the latter, which finds application in electric heavy duty trucks. This could provide incremental orders to AAL. The street expects operational synergies to accrue to AAL as a step-down subsidiary of one of the major global auto-component suppliers.

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. However AAL's efforts to diversify its revenue streams by scaling up its presence in other segments such as defence and off-highway applications, are expected to yield benefits over the medium to long-term. Further, the company is exposed to the susceptibility of profitability to fluctuations in prices of key raw materials, although it is expected to pass on the impact of the same to its customers with some lag.

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.

Margins have been slow to rise despite the leading position, falling commodity costs and cost efficiency measures. AAL enters into related party transactions with Meritor HVS India (90% sales of Rs.1818 cr in FY23 to them).

Company Background:

Established in 1981, Automotive Axles Limited (AAL) is a joint venture of Kalyani Group and Meritor Inc., USA (acquired by Cummins in CY23). 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)	FY21	FY22	FY23	FY24E	FY25E
Net Revenues	**906**	**1491**	**2324**	**2593**	**2860**
Growth (%)	***-4.9***	***64.6***	***55.9***	***11.6***	***10.3***
Operating Expenses	840	1356	2066	2300	2526
EBITDA	**66**	**135**	**257**	**293**	**335**
Growth (%)	***-29.4***	***104.6***	***91.2***	***13.8***	***14.2***
EBITDA Margin (%)	***7.3***	***9.0***	***11.1***	***11.3***	***11.7***
Depreciation	36	36	41	38	40
Other Income	7	4	5	10	11
EBIT	**37**	**103**	**221**	**265**	**306**
Interest expenses	3	2	3	3	3
Exceptional items	-4	0	0	0	0
PBT	**30**	**100**	**218**	**262**	**303**
Tax	7	26	56	67	77
PAT	**23**	**74**	**162**	**195**	**226**
Adj. PAT	**23**	**74**	**162**	**195**	**226**
Growth (%)	***-44.8***	***227.4***	***117.9***	***20.6***	***15.5***
EPS	15.0	49.2	107.2	129.3	149.5

Balance Sheet

As at March (Rs cr)	FY21	FY22	FY23	FY24E	FY25E
SOURCE OF FUNDS					
Share Capital	15	15	15	15	15
Reserves	539	606	744	882	1042
Shareholders' Funds	**554**	**621**	**759**	**897**	**1057**
Borrowings	15	15	10	6	2
Net Deferred Taxes	-8	-8	-5	-5	-5
Other Non-curr. Liab.	9	7	16	19	21
Total Source of Funds	**570**	**635**	**780**	**918**	**1075**
APPLICATION OF FUNDS					
Net Block & Goodwill	245	259	245	226	212
CWIP	32	3	6	8	6
Investments	12	17	0	220	335
Other Non-Curr. Assets	25	20	18	41	46
Total Non-Current Assets	**315**	**299**	**270**	**495**	**599**
Inventories	201	199	231	284	313
Trade Receivables	282	389	499	462	486
Cash & Equivalents	73	81	46	57	61
Other Current Assets	66	69	106	71	71
Total Current Assets	**621**	**738**	**881**	**874**	**931**
Trade Payables	290	345	316	391	392
Current Liab & Provisions	76	57	55	60	63
Total Current Liabilities	**367**	**403**	**371**	**451**	**455**
Net Current Assets	**255**	**335**	**510**	**423**	**477**
Total Application of Funds	**570**	**635**	**780**	**918**	**1075**

Cash Flow Statement

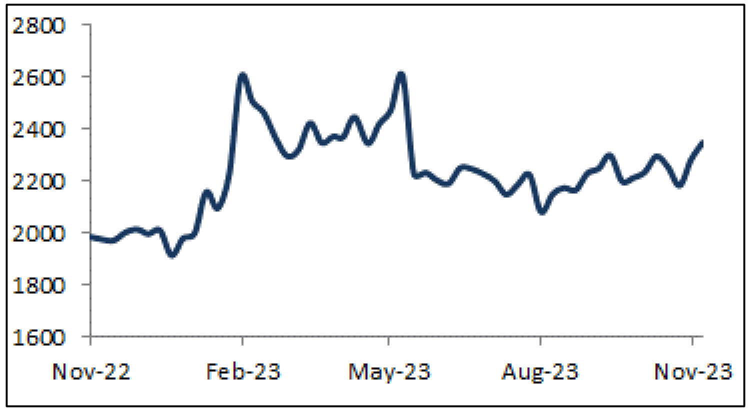
(Rs cr)	FY21	FY22	FY23	FY24E	FY25E
PBT	30	100	218	262	303
Non-operating & EO items	2	1	11	-19	-2
Interest Expenses	36	36	41	38	40
Depreciation	3	2	-2	3	3
Working Capital Change	-13	-74	-165	98	-49
Tax Paid	-9	-23	-53	-67	-77
OPERATING CASH FLOW (a)	**49**	**43**	**52**	**315**	**217**
Capex	-34	-22	-16	-20	-24
Free Cash Flow	14	21	36	295	193
Investments	-12	-4	17	-220	-115
Non-operating income	7	0	-85	0	0
INVESTING CASH FLOW (b)	**-40**	**-27**	**-84**	**-240**	**-139**
Debt Issuance / (Repaid)	-4	-4	-4	-4	-4
Interest Expenses	-3	-2	-2	-3	-3
FCFE	2	10	-39	68	71
Share Capital Issuance	0	0	0	0	0
Dividend	-1	-7	-23	-57	-66
Others	-2	-2	-2	0	0
FINANCING CASH FLOW (c)	**-10**	**-15**	**-31**	**-64**	**-74**
NET CASH FLOW (a+b+c)	**-1**	**2**	**-63**	**11**	**4**

Key Ratios

	FY21	FY22	FY23	FY24E	FY25E
Profitability Ratios (%)					
EBITDA Margin	7.3	9.0	11.1	11.3	11.7
EBIT Margin	4.1	6.9	9.5	10.2	10.7
APAT Margin	2.5	5.0	7.0	7.5	7.9
RoE	4.2	12.7	23.5	23.6	23.1
RoCE	6.6	17.0	31.5	31.7	31.2
Solvency Ratio (x)					
Net Debt/EBITDA	-0.9	-0.5	-0.1	-0.2	-0.2
Net D/E	-0.1	-0.1	0.0	-0.1	-0.1
PER SHARE DATA (Rs)					
EPS	15.0	49.2	107.2	129.3	149.5
CEPS	38.9	73.3	134.6	154.6	175.8
BV	366.7	411.0	502.5	593.8	699.3
Dividend	4.5	15.0	32.0	38.0	44.0
Turnover Ratios (days)					
Inventory	114	95	78	65	62
Debtor	87	54	41	45	45
Creditors	126	93	56	62	57
VALUATION (x)					
P/E	156.1	47.7	21.9	18.1	15.7
P/BV	6.4	5.7	4.7	4.0	3.4
EV/EBITDA	53.0	25.8	13.6	11.9	10.4
EV/Revenues	3.9	2.3	1.5	1.3	1.2
Dividend Yield (%)	0.2	0.6	1.4	1.6	1.9
Dividend Payout (%)	29.9	30.5	29.8	29.4	29.4

(Source: Company, HDFC sec)

Price chart



HDFC Sec Retail Research Rating description

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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.

ATUL JAGDISH KARWA

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