July 21, 2010

Automotive Axle (AUTAXL)

Rs 491

Rating matrix

Rating	:	**Buy**
Target	:	Rs 547
Target Period	:	12 months
Potential Upside	:	11%

Key Financials

(Rs Crore)	SY09	SY10E	SY11E
Net Sales	267.2	687.3	746.7
EBITDA	32.9	96.1	113.3
Net Profit	5.4	48.4	63.7
EPS	3.6	33.0	42.1

SY~September year end

Valuation summary

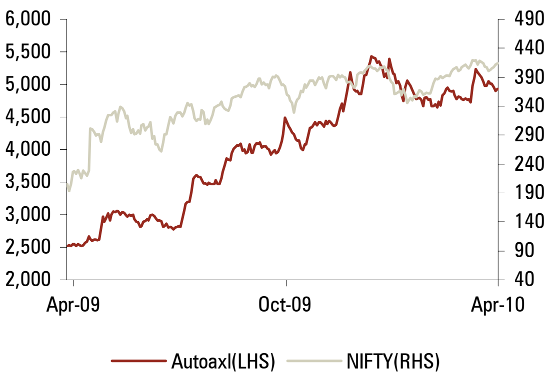
	SY09	SY10E	SY11E
PE (x)	131.6	14.2	11.1
Target PE (x)	153.7	16.6	13.0
EV to EBITDA (x)	22.6	8.1	6.1
Price to book (x)	4.1	3.3	2.7
RoNW (%)	3.1	25.7	26.5
RoCE (%)	6.3	31.6	33.2

SY~September year end

Stock data

Mcap	Rs708.4crore
Debt (Mar'10)	Rs38crore
Cash (Mar'10)	Rs1.5crore
EV	Rs744.9crore
52 week H/L	Rs 434/ 70
Equity cap	Rs15.1crore
Face value	Rs 10
MF Holding	10.6%
FII Holding	0.6%

Price movement



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WHAT'S CHANGED...

PRICE TARGET .... Changed from Rs 525 to Rs 547
EPS (FY10E) .... Changed from Rs 24.8 to Rs 33
EPS (FY11E) .... Changed from Rs 29.7 to Rs 42.1
RATING............ Change from Add to Buy

Topline provides a pleasant surprise...

Automotive Axles (AAL) reported impressive Q3FY10 numbers by beating our estimates with the topline galloping 197.7% YoY and 15.4% QoQ to Rs 196.2 crore on the back of an increase in share of sales from OEMs and improvement in realisation on renegotiation of prices with OEMs. AAL had a lesser than anticipated sequential margin shrinkage of 80 bps due to better cost management initiatives and inventory control even though raw material costs rose by 70 bps during the same period. EBITDA grew 11.7% QoQ and 262.3% YoY to touch Rs 27.5 crore. Net profit zoomed to Rs 14.5 crore with 439.4% YoY and 17.9% QoQ growth. The continuance of strong commercial vehicles (CV) demand due to the resounding domestic economic performance is expected to get reflected in the coming quarter as well.

Strong economic growth fuels demand

Continuing with the traction gained from Q4FY10, economic recovery has been robust leading to an increase in sales volumes in the medium and heavy CV (M&HCV) segment for industry leaders like Tata Motors and Ashok Leyland. AAL, as one of the major suppliers to these companies, has been a major beneficiary of the higher offtake in the CV space.

Export segment a cause for concern

The exports business of the company is channelled through its JV partner Arvin Meritor to various OEMs across the globe. However, the immediate concern is the slowdown in demand arising in the European and American continents due to the sluggish pace of economic recovery reflected in the 16.2% QoQ drop in sales from exports. The company is increasingly focusing on internal demand arising from OEMs.

Valuation

The bright CV sales outlook is expected to further improve AAL's volumes and subsequent market share. The stock is currently trading at Rs 491, 11.7x SY11E EPS of Rs 42.1. We have valued the business at 13x SY11E EPS of Rs 42.1 to arrive at a valuation of Rs 547, which implies an 11.4% upside potential. Hence, we have changed our rating on the stock to **BUY.**

Exhibit 1: Financial Performance

(Rs Crore)	Q3SY10	Q3SY10E	Q3SY09	Q2SY10	QoQ (Chg %)	YoY (Chg %)
Net Sales	196.2	161.8	65.9	170.0	15.4	197.7
EBITDA	27.5	22.2	7.6	24.6	11.7	262.3
EBITDA Margin (%)	14.0	13.7	11.5	14.5	-3.2	21.7
Depreciation	5.4	5.7	4.6	5.4	0.6	16.1
Interest	0.6	1.0	1.3	0.7	-6.1	-50.6
Reported PAT	14.5	7.4	2.7	12.3	17.9	439.4
EPS (Rs)	9.6	4.9	1.8	8.2	17.9	439.4

SY~September year end

Source: Company ICICIdirect.com Research

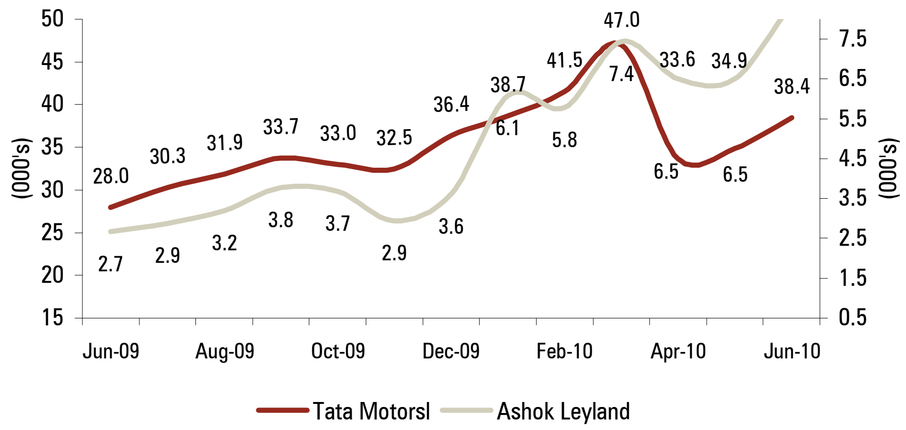
Management outlook

Our discussion with the management highlighted the fact that they have been able to renegotiate on the pricing issue of axles with their major OEM clients leading to a significant jump in the realisation and topline. The increased domestic focus has led to an increase in market share. This has also led to the contribution from Ashok Leyland and Tata Motors rising to ~91% of the total topline. The management is bullish on the continuance of the upswing in the strong overall performance of the company in the last quarter.

The management also has a positive outlook towards further capacity expansion plans over six months to increasing sales from the export segment, which, at present, is languishing. The fund raising activities would be driven primarily through debt and internal accruals as the debt to equity ratio is at a comfortable 1:2.6 levels, thereby providing enough headroom.

The commercial vehicle sales trend reflects the subsequent bounce back of sales post April reflecting the strong demand scenario even in a traditionally lean quarter

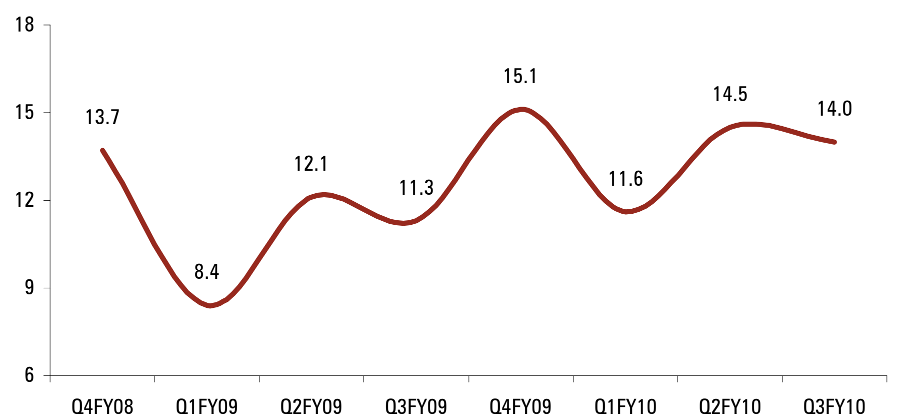
Exhibit 2: CV sales performance of major clients



Source: ICICIdirect.com Research

The company managed to arrest the sequential decline in margin to only 50 bps on the back of cost rationalisation at the operational level to reduce the higher raw material cost impact on margin

Exhibit 3: Margin movement (%)



Source: Company, ICICIdirect.com Research

Outlook & Valuations

Outlook

Automotive Axle has exhibited a stronger performance on the back of an improving demand scenario from OEMs. We expect the company to continue with its impressive performance and achieve a topline of Rs 683 crore for SY10E. Going forward, we expect a softening of raw material prices along with further cost rationalisation measures, which would lead to margin improvement in the next quarter.

Valuation

The stock is currently trading at Rs 491, 11.7x SY11E EPS of Rs 42.1. We have valued the business at 13x SY11E EPS of Rs 42.1 to arrive at a valuation of Rs 547, which implies an 11.4% upside potential. We have revised our estimates upwards in light of the strong operational performance in this quarter and expected improvement, going forward, on the back of increasing CV demand. We have upgraded the stock from ADD to **BUY.**

Exhibit 4: Revision of financial estimates

(Rs crore)	Old FY10E	New FY10E	%chg.	Old FY11E	New FY11E	%chg.
Net sales	539.9	687.3	27.3	641.3	746.7	16.4
EBITDA	78.0	96.1	23.2	90.9	113.3	24.6
EBITDA margins (%)	14.5	14.0	(51.4)bps	14.2	15.2	100bps
Net Profit	37.5	48.4	29.0	45	63.7	41.5
EPS (Rs)	24.8	33.0	33.2	29.7	42.1	41.8

SY~September year end

Source: ICICIdirect.com Research

Exhibit 5: ICICIdirect.com Research coverage universe

Tata Motors					**Sales (Rs cr)**	**EPS (Rs)**	**PE(x)**	**EV/E (x)***	**RoNW (%)**	**RoCE (%)**
Idirect Code	TELCO	**CMP**	813	**FY09**	25,354.1	13.4	60.7	55.9	6.9	7.1
		Target	877	**FY10E**	35,373.8	39.3	20.7	17.4	15.4	12.2
Mcap (Rs cr)	41766.6	**% Upside**	7.9	**FY11E**	38,958.3	51.7	15.7	15.2	16.6	11.0
				FY12E	45,870.6	57.1	14.2	13.7	16.1	11.1
Maruti Suzuki					**Sales (Rs cr)**	**EPS (Rs)**	**PE(x)**	**EV/E (x)***	**RoNW (%)**	**RoCE (%)**
Idirect Code	MARUTI	**CMP**	1362	**FY09**	20,775.6	40.3	33.8	19.5	13.3	18.5
		Target	1614	**FY10E**	31,684.5	84.0	16.2	9.5	23.1	33.3
Mcap (Rs cr)	39366.1	**% Upside**	18.5	**FY11E**	34,957.7	94.0	14.5	8.7	21.0	28.9
				FY12E	37,714.7	101.8	13.4	7.9	18.8	26.4
M&M					**Sales (Rs cr)**	**EPS (Rs)**	**PE(x)**	**EV/E (x)***	**RoNW (%)**	**RoCE (%)**
Idirect Code	MAHMAH	**CMP**	602	**FY09**	13,093.7	15.3	39.2	34.3	17.4	9.9
		Target	675	**FY10E**	18,602.1	36.9	15.9	12.2	31.9	25.8
Mcap (Rs cr)	32826.2	**% Upside**	12.2	**FY11E**	22,165.9	36.8	16.4	10.9	23.9	25.6
				FY12E	25,487.6	41.8	14.4	9.6	22.1	25.8
Bajaj Auto					**Sales (Rs cr)**	**EPS (Rs)**	**PE(x)**	**EV/E (x)***	**RoNW (%)**	**RoCE (%)**
Idirect Code	BAAUTO	**CMP**	2,396	**FY09**	8,696.2	44.4	54.0	34.1	40.1	38.5
		Target	2,567	**FY10E**	11,810.6	115.4	18.2	14.1	72.4	68.1
Mcap (Rs cr)	34671.1	**% Upside**	7.1	**FY11E**	15,244.7	143.1	16.7	12.9	57.9	62.0
				FY12E	17,092.8	171.1	14.0	10.6	49.0	38.5
Escorts*					**Sales (Rs cr)**	**EPS (Rs)**	**PE(x)**	**EV/E (x)***	**RoNW (%)**	**RoCE (%)**
Idirect Code	ESCORT	**CMP**	201	**FY08**	1,998.0	1.3	153.8	26.1	-1.6	7.0
		Target	220	**FY09**	2,162.8	9.9	20.3	12.2	8.5	10.6
Mcap (Rs cr)	1897.7	**% Upside**	9.3	**FY10E**	2,830.7	15.1	13.4	8.7	9.8	13.2
				FY11E	3,236.5	17.8	11.3	7.3	10.4	14.1
Apollo Tyres					**Sales (Rs cr)**	**EPS (Rs)**	**PE(x)**	**EV/E (x)***	**RoNW (%)**	**RoCE (%)**
Idirect Code	APOTYR	**CMP**	64	**FY09**	4,070.4	2.1	30.3	10.8	7.8	14.6
		Target	85	**FY10E**	5,036.8	8.2	7.8	4.8	26.9	30.8
Mcap (Rs cr)	3119.1	**% Upside**	33.0	**FY11E**	5,875.8	8.1	7.9	4.5	21.3	24.1
				FY12E	6,376.1	8.4	7.6	4.4	18.5	21.2
Automotive Axle*					**Sales (Rs cr)**	**EPS (Rs)**	**PE(x)**	**EV/E (x)***	**RoNW (%)**	**RoCE (%)**
Idirect Code	AUTAXL	**CMP**	491	**FY08**	751.9	39.6	12.4	6.5	37.7	40.4
		Target	547	**FY09**	267.2	3.6	137.7	22.6	3.1	6.3
Mcap (Rs cr)	741.7	**% Upside**	11.6	**FY10E**	687.3	33.0	14.8	8.1	25.7	31.6
				FY11E	746.7	42.1	11.7	6.1	26.5	33.2
Balkrishna Industries					**Sales(Rs cr)**	**EPS (Rs)**	**PE(x)**	**EV/E (x)***	**RoNW (%)**	**RoCE (%)**
Idirect Code	BALIND	**CMP**	577	**FY09**	1,252.5	36.0	16.0	6.7	15.9	20.9
		Target	689	**FY10E**	1,394.4	107.9	5.3	7.1	37.0	28.6
Mcap (Rs cr)	1115.0	**% Upside**	19.5	**FY11E**	1,622.0	122.1	4.7	4.7	30.6	24.2
				FY12E	1,862.7	125.3	4.6	4.9	24.4	19.7
Bharat Forge					**Sales(Rs cr)**	**EPS (Rs)**	**PE(x)**	**EV/E (x)***	**RoNW (%)**	**RoCE (%)**
Idirect Code	BHAFOR	**CMP**	333	**FY09**	2,057.6	4.3	77.1	19.9	6.5	11.8
		Target	352	**FY10E**	1,856.4	5.7	58.4	20.1	8.4	9.1
Mcap (Rs cr)	7418.1	**% Upside**	5.6	**FY11E**	2,521.3	9.5	35.1	14.1	11.5	11.9
				FY12E	3,070.1	12.8	26.0	12.3	12.5	12.6
JK Tyres					**Sales (Rs cr)**	**EPS (Rs)**	**PE(x)**	**EV/E (x)***	**RoNW (%)**	**RoCE (%)**
Idirect Code	JKIND	**CMP**	166	**FY09**	4,934.1	4.6	35.7	6.3	3.5	12.5
		Target	211	**FY10E**	3,678.0	39.9	4.2	4.9	25.2	17.9
Mcap (Rs cr)	681.0	**% Upside**	27.2	**FY11E**	4,338.8	43.7	3.8	4.6	22.1	16.5
				FY12E	4834.9	52.8	3.1	4.1	21.6	16.7
Subros					**Sales (Rs cr)**	**EPS (Rs)**	**PE(x)**	**EV/E (x)***	**RoNW (%)**	**RoCE (%)**
Idirect Code	SUBROS	**CMP**	49	**FY09**	694.4	2.2	22.3	6.1	7.6	12.2
		Target	61	**FY10E**	875.6	3.9	12.5	4.1	12.1	16.5
				FY11E	931.0	5.6	8.7	3.0	15.5	20.9
Mcap (Rs cr)	293.6	**% Upside**	24.0	**FY12E**	1,081.7	6.7	7.3	2.5	16.2	22.6

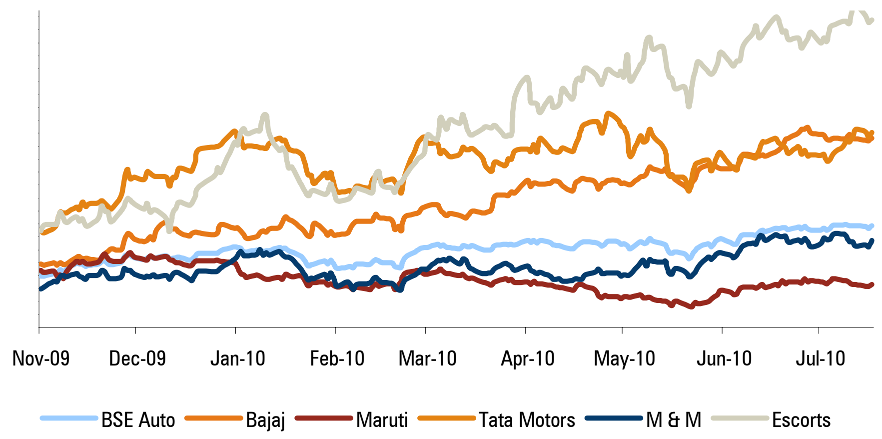
Source: Company, ICICIdirect.com Research

ICICI direct.com Universe price movement vis-à-vis BSE Auto index

The chart compares the movement of OEM stocks in the ICICIdirect.com Universe with the BSE Auto index, thereby reflecting the degree of mimicking of the index

Since mid-February 2010, Bajaj Auto, Tata Motors and Escorts have outperformed while Maruti Suzuki has underperformed in comparison to the index by being divergent on the upside and downside, respectively

Exhibit 6: OEM comparison with BSE Auto

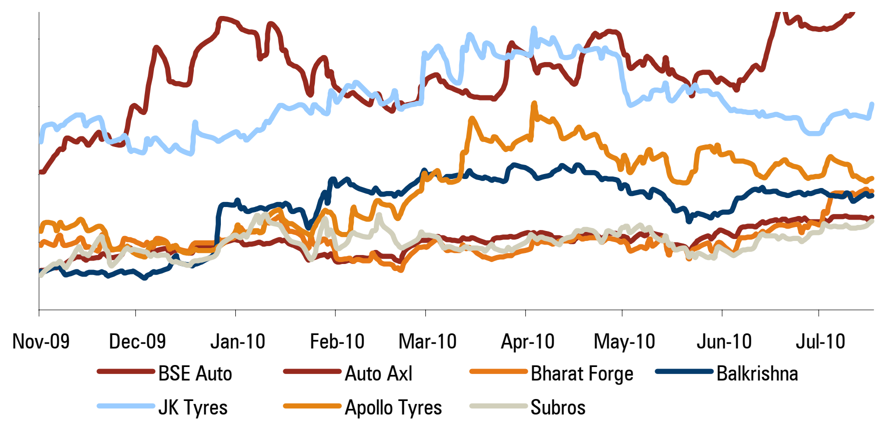


Source: Company, ICICIdirect.com Research

The chart compares the movement of auto ancillary stocks in the ICICIdirect.com universe with the BSE Auto index

The volatile nature of smaller ancillary companies is reflected. These have met with numerous fluctuations with the exception of larger market capitalisation companies like Bharat Forge, which mimic the index greatly

Exhibit 7: Ancillaries comparison with BSE Auto



Source: Company, ICICIdirect.com Research

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