Amtek Auto - BUY

CMP Rs178, Target Rs212

Sector: Auto components

Sensex:	17,774
CMP (Rs):	178
Target price (Rs):	212
Upside (%):	19.1
52 Week h/l (Rs):	239 / 92
Market cap (Rscr) :	3,791
6m Avg vol ('000Nos):	1,264
No of o/s shares (mn):	210
FV (Rs):	2
Bloomberg code:	AMTK IB
Reuters code:	AMTK.BO
BSE code:	520077
NSE code:	AMTEKAUTO

Prices as on 07 Jul, 2010

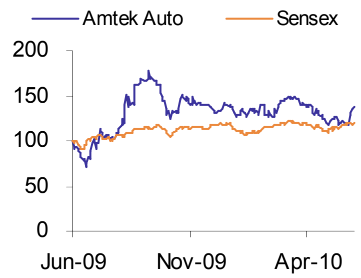
Shareholding pattern

March '10	(%)
Promoters	29.0
Institutions	49.0
Non promoter corp hold	6.5
Public & others	15.5

Performance rel. to sensex

(%)	1m	3m	1yr
Amtek Auto	6.0	(6.4)	15.1
Bosch	4.3	11.0	48.0
MSSL	(1.6)	8.9	94.3
Bharat Forge	5.0	15.5	71.4

Share price trend



Indian auto component industry is witnessing resurgent times following a strong domestic auto industry growth. Amtek Auto is one large company in this space where, we believe, the worst is over in terms of its international business contraction. **The company's international operations**, which suffered a beating (following a slew of acquisitions during 2002-07) post the outburst of Subprime crisis, **have now bottomed out**. International business may take time to recover but can only improve from hereon. Capacity utilization at ~30%, possibly its lowest point; any rise makes a case for margin expansion (flexible raw material pricing supports) with operating leverage kicking in.

The big story will be supply to the domestic auto industry that has been growing at a fast pace supported by rising incomes, easy availability of finance and low penetration levels. With a plethora of OEMs setting up shop in India, especially to supply small cars at competitive prices, local sourcing of components from players like Amtek is the need of the hour. Lower manufacturing costs coupled with high quality of products are making India a sourcing hub for automobile components.

To break-away from the vagaries of cyclicality of autos over time, Amtek is **diversifying into non-automotive areas** like the defence segment and wagon manufacturing and components in railways. The management expects non-automotive revenue contribution to rise to 40% in 2014 from 9% currently.

Amtek Auto has a diversified business profile, catering to a vast customer base (top five customers contributing less than 15% of revenues). **Consolidated revenues have witnessed a CAGR of 34% over the last five years** and we expect it to grow by 11% and 10% in F6/11 and F6/12 respectively **(PAT CAGR of 45.6% over F6/09 to F6/12).**

Concerns on international business are largely in the price, in our opinion. Over the past one year, Amtek Auto has under performed its peers (Bharat Forge, Bosch, Motherson Sumi) by a huge margin. Even based on our bear case scenario, the stock trades at a P/E of 12x (P/E of 8x based on bull case). We initiate coverage with BUY rating; upside of 19.1% in 6-9 months.

Valuation summary (Consolidated)

Y/e 31 Mar (Rs m)	F6/09	F6/10E	F6/11E	F6/12E
Revenues	34,386	36,636	40,483	44,531
yoy growth (%)	(26.2)	6.5	10.5	10.0
Operating profit	7,004	8,976	10,526	11,266
OPM (%)	20.4	24.5	26.0	25.3
Reported PAT	1,728	3,043	4,782	5,396
yoy growth (%)	(59.6)	76.1	57.1	12.8
EPS (Rs)	12.3	15.1	20.4	23.0
P/E (x)	14.6	11.8	8.8	7.8
Price/Book (x)	0.8	0.8	0.8	0.8
EV/EBITDA (x)	8.0	6.3	5.2	4.2
Debt/Equity (x)	1.2	0.7	0.5	0.4
RoE (%)	5.6	8.0	10.2	10.2
RoCE (%)	6.3	8.2	10.0	10.7

Source: Company, India Infoline Research

Research Analyst

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Strong growth in OEM to drive domestic demand

~70% of the revenue is generated from the 4-Ws segment

~70% of Amtek Auto's total revenue is derived from 4-Ws segment; with CV's and 2/3-Ws contributing the balance 11% and 9% respectively. Within the automotive segment, the company caters largely (>90%) to the OEM market.

We expect demand for 4-Ws to remain strong for next three years driven by 1) Rising disposable income thereby leading to strong rural demand, 2) Robust urban demand on back of easy finance availability, 3) Entrance of new players and a slew of launches and 4) Increasing demand towards replacement.

CVs contribute ~11% of the total revenues for the company

Impetus given by the Government of India towards building Road and Infrastructure across the country and increase in allocation to JNNURM is expected to translate into strong growth for CVs.

2/3-Ws contribute ~9% to the total revenue

Increase in rural penetration and improved consumer sentiment in urban areas will aid growth for 2-Ws in the next three-four years.

Exports have bottomed out

Amtek Auto reported a substantial decline in its exports from F6/08 to F6/09 (to US$50mn as against ~US$250mn) on the back of poor demand scenario prevailing in the Western markets. With dark clouds over global slowdown likely to have faded, we expect the exports for the company to grow at a steady rate on account of two factors:

Low cost and high quality has made India a major sourcing hub for auto components

- **India to become a major sourcing hub**: Low costs of manufacturing coupled with high quality of products have made India a sourcing hub for automobile components. Over the years, auto components companies in India have moved up the value chain from basic components manufacturer to suppliers of highly developed products involving R&D. Amtek Auto has been the major beneficiary of this transformation as it continues to move up the value chain with a broader geographical footprint and product offering**.**

Indian auto components players are expected to play vital role in R&D for auto components going ahead

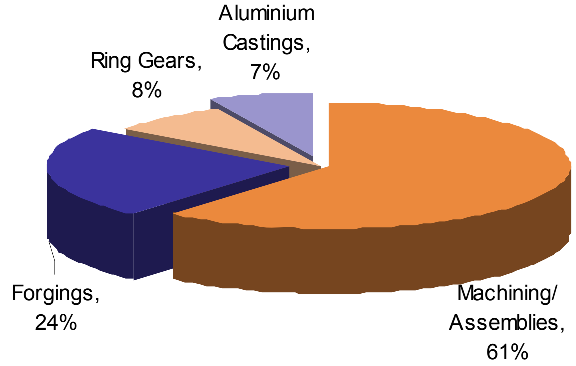
- **Shift in buying pattern globally**: We believe global 4-Ws market will be driven by a shift from bigger cars to compact or smaller cars. An added impetus would be provided by government's focus on lowering fuel consumption. Furthermore, environmental issues are likely to propel investments towards developing cleaner technologies and hybrid vehicles based on fuels such as natural gas and hydrogen. This will require component manufacturers to be deeply involved in research and development technologies. We believe India, with its skilled man-power and government incentives for R&D, will play a vital role.

Huge client base, diversified product profile

Diversified product offering coupled with wide client base

Amtek Auto has been catering to a vast customer base, with top 5 customers contributing less than 20% of the total revenues. This, in turn has enabled the company to avoid client concentration and thereby reduce risk. The wide customer base could largely be attributed to diversified product profile in offerings. With over 200 products, the company has a niche presence across segments of forging, aluminum castings (nascent stage), machining/ assemblies and ring gears business.

Product segmentation (F6/09)



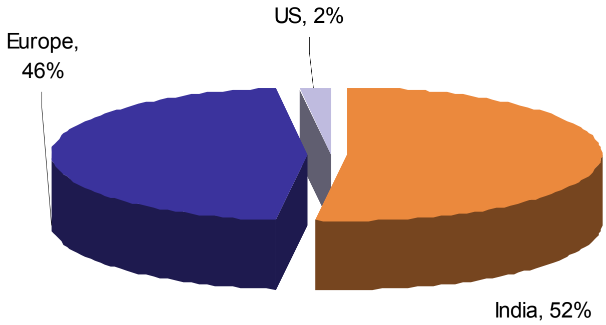
Source: Company, India Infoline Research

Margins for overseas subsidiaries at trough

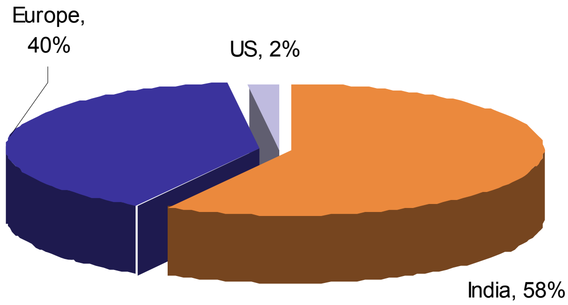
Geographical diversification of revenues through acquisition in the western countries

Amtek Auto had made a slew of acquisitions during 2002-07, at both domestic and international front. However, the grim demand scenario in the Western countries, had largely affected the performance of its overseas subsidiaries. The company reported a mediocre 5.3% OPM for F6/09. We do not expect any significant rise in OPM for the current year, as utilization levels continue to remain lower at ~30-35%. With margins expected to have bottomed out, we do not expect any further downside on the margin front from the current levels. Factoring in the utilization levels at 40-50% levels for the next two years, we expect margins to increase to 10% and 12% for F6/11 and F6/12 respectively.

Geographical segmentation (F6/08)



Geographical segmentation (F6/09)



Source: Company, India Infoline Research

Shift in focus towards non-automotive segment

Auto component manufacturers catering only to automobile industry are exposed to cyclical nature of the industry. As a hedge, many auto component players have entered into non–automotive segment. Amtek Auto currently generates ~9% of its revenues from the non –automotive segment viz. Railways and Defence segment. However, with significant expansions planned in the non-automotive segment, the company has targeted to increase the share of non-automotive segment in total revenues to ~37% by 2014.

Capacity expansion planned in the railway segment will boost contribution from this segment

- **Railway Segment: New capacity to boost revenues**

  Amtek Auto generates revenue from two businesses in the railway space: 1) Wagon manufacturing and 2) Rail components.

  Wagon manufacturing: The company has entered into a 50-50 joint venture with American Railcar Industries (a US$800mn company), which is the largest manufacturer of specialized Freight cars/ Wagons, Railway tank Wagons in USA. The JV has set up a wagon manufacturing plant near Chandigarh, with an initial capacity of 2,400 wagons per annum, production for which is expected to commence from F6/11. The capacity for the plant will be further raised to 3,000 wagons per annum in 2012. The company targets wagon manufacturing business to contribute ~US$400mn in sales annual for the next four years.

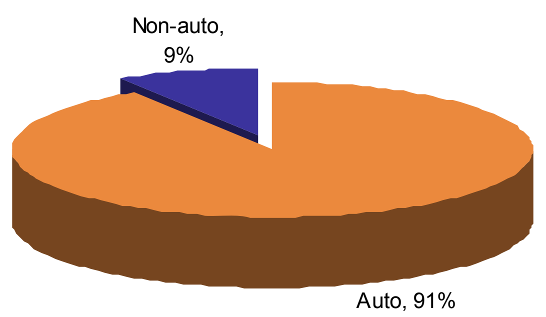
  Rail component: Amtek Auto plans to manufacture ~17 new products in the rail component business. This is expected to increase the revenue from current Rs4bn to Rs15bn over the next 3-4 years.

New product offering planned in the defense segment

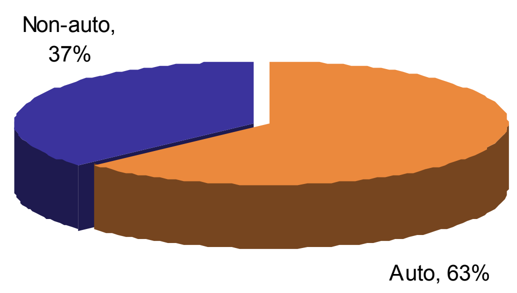
- **Defence segment**

  Defence segment contributed ~Rs800mn in F6/09. Amtek Auto supplies some parts of tanks and shell forging to the defence segment. Currently, there are ~ 4,000 tanks which are due for up-gradation. This is expected to translate into strong growth in revenues. The company presently supplies a single variety of shell forging. However, it plans to increase the product offering by supplying 8 more varieties of shell forging. With these expansions plans, the company expects the defence segment to contribute ~Rs1,200mn to the revenue in next four years.

Revenue segmentation (F6/09)



Revenue segmentation (F6/14E)



Source: Company, India Infoline Research

Amtek Auto supplies a gamut of product range to the OEM industry. Given the cyclical nature of the automobile industry, we have prepared three case scenarios for the company:

Scenario-I (Bear Case scenario)

We arrive at a fair value of Rs158 under a bear case scenario

Under a bear case scenario, we have assumed a modest growth of 5% and 10% in revenues for Indian operations in F6/11 and F6/12 respectively. In case of a sharp rise in raw material prices and the inability of the company to fully pass on the same, OPM is expected to decline by 300bps for F6/11 and 180 bps in F6/12. For overseas operations, we assume revenue decline to the extent of 10% in F6/10 and thereafter a rise of 5% in F6/12. Current utilization levels for its overseas subsidiaries are approximately 31%. This allows ample scope to benefit from operating leverage.

In a bear case scenario we have not factored in any increase in utilization levels for overseas subsidiaries assuming a continued grim demand scenario. On a blended basis, OPM for the company in a bear case scenario turns out to be 22.8% and 21.9% in F6/11 and F6/12 respectively translating into an EPS of Rs14 for F6/11 and Rs16 for F6/12. Assigning, P/E multiple of 11x to F6/11 EPS of Rs14, we arrive at a fair value of Rs158 under a bear case scenario.

Scenario-II (Base Case scenario)

Assigning a P/E multiple of 11x, to F6/11 EPS of Rs19.3, we arrive at a target price of Rs212

Given the strong demand outlook for the automobile over the next two years, we have assumed revenue growth of 12% and 10% in F6/11 and F6/12 respectively for Indian operations. Under the base case scenario, the company would usually follow a policy of passing on the complete hike in raw material prices resulting in an OPM of 29.0% and 28.5% in F6/11 and F6/12 respectively for India operations.

For overseas operation, we expect the revenues to grow by 5% and 10% in F6/11 and F6/12 respectively. Benefits of operating leverage due to increase in utilization levels will lead to expansion in OPM to 10% and 12% in F6/11 and F6/12 respectively. This will result in OPM of 25.1% in F6/11 and F6/12 respectively for the consolidated entity resulting in an EPS of Rs19.3 and Rs23 for F6/11 and F6/12 respectively. Assigning a P/E multiple of 11x, to F6/11 EPS of Rs19.3, we arrive at a target price of Rs212.

Scenario-III (Bull Case scenario)

Assigning a P/E multiple of 11x to F6/11 EPS of Rs24, we arrive at a fair value of Rs261 in the bull case scenario

Multiple factors are taken into consideration in a bull case scenario: 1) Continuation of the strong demand for automobiles in the domestic market, 2) Improvement in European demand considerably resulting in higher utilization levels from ~30% to 35% in F6/10 for overseas subsidiaries, 3) Accelerated increase in outsourcing from Europe to India, which stands at 10% currently. The above mentioned factors will corroborate the expansion in OPM for the consolidated entity to 27% and 28% in F6/11 and F6/12 respectively translating into an EPS of Rs24 and Rs31 in F6/11 and F6/12 respectively. Assigning a P/E multiple of 11x to F6/11 EPS of Rs24, we arrive at a fair value of Rs261 in the bull case scenario.

F6/11 estimates for three scenarios

Particulars	Bear Case	Base Case	Bull Case
India Operations			
Revenues	30,122	32,130	33,851
Revenue growth	5%	12%	18%
Operating Profit	8,073	9,318	10,155
OPM (%)	26.8%	29.0%	30.0%
Overseas Operations			
Revenues	7,154	8,346	9,936
Revenue growth	-10%	5%	25%
Operating Profit	429	835	1,490
OPM (%)	6.0%	10.0%	15.0%
Total			
Revenues	37,276	40,476	43,787
Operating Profit	8,502	10,152	11,646
OPM (%)	22.8%	25.1%	26.6%
APAT	**3,367**	**4,521**	**5,565**
EPS	**14**	**19**	**24**
P/E x 12	**173**	**232**	**285**
P/E x 11	**158**	**212**	**261**
P/E x 10	**144**	**193**	**238**

F6/12 estimates for three scenarios

Particulars	Bear Case	Base Case	Bull Case
India Operations			
Revenues	33,134	35,343	38,929
Revenue growth	10%	10%	15%
Operating Profit	8,284	10,073	11,679
OPM (%)	25.0%	28.5%	30.0%
Overseas Operations			
Revenues	7,511	9,181	11,923
Revenue growth	5%	10%	20%
Operating Profit	601	1,102	2,385
OPM (%)	8.0%	12.0%	20.0%
Total			
Revenues	40,646	44,524	50,852
Operating Profit	8,884	11,174	14,063
OPM (%)	21.9%	25.1%	27.7%
APAT	**3,731**	**5,332**	**7,352**
EPS	**16**	**23**	**31**
P/E x 12	**191**	**273**	**377**
P/E x 11	**175**	**251**	**345**
P/E x 10	**159**	**228**	**314**

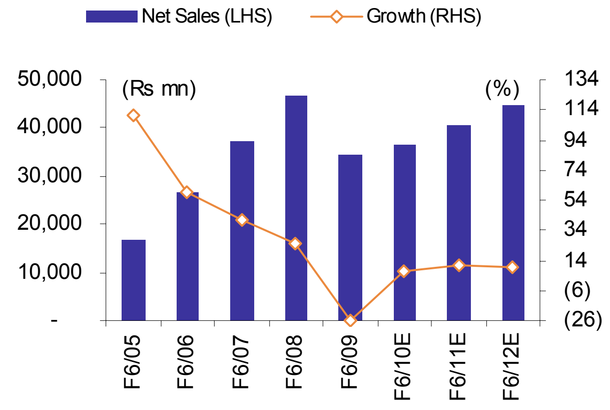
Source: Company, India Infoline Research

We expect the revenues for the company to grow by 20% and 18% in F6'11 and F6'12 respectively

Consolidated revenues witnessed CAGR of 34% over 5 years

Consolidated revenues for the company have witnessed a CAGR of 34% over the past 5 years. We expect revenues for the company to grow at 11% and 10% in F6/11 and F6/12 respectively. This growth will be driven by strong demand in the automotive segment in India. Further, recovery in revenues from the JVs and subsidiaries will fuel the growth. The company has planned major expansions at non-automotive space, which in our view will translate into strong growth from non-auto sector.

Trend in consolidated revenue



Source: Company, India Infoline Research

The company has a flexible pricing policy, wherein the company passes on any hike or benefit in raw material cost

Raw Material cost: Flexible pricing policy offsets volatility risk

Raw material costs, which accounts for 55%-60% of sales consist mainly of steel. The company follows a flexible policy of passing on any increase or benefit in raw material cost to its customers. This acts as a natural hedge against the volatility in steel prices.

The margins for the company are expected to be stable

Margins to stay resilient

The company posted OPM of 20.4% in F6/09. We expect OPM to improve to 24.5% in F6/10 and further to 25.1% in F6/11 and F6/12 each. This improvement in margins would be a direct result of enhanced margins at the overseas front coupled with the advantage of operating leverage.

FCCB redemption

Amtek Auto currently has US$143.5mn of FCCBs outstanding on the books, of which US$116.1mn (conversion price Rs458.64) is due for redemption on June 2011. This would translate into cash outflow of Rs5.5bn (Rs/US$@ 47). Remaining, US$27.4mn (conversion price Rs148.4) is due on June 2014. We expect these to get converted during F6/11, leading to cash infusion of Rs1.3bn (9mn shares @ Rs148.4).

Key Concerns

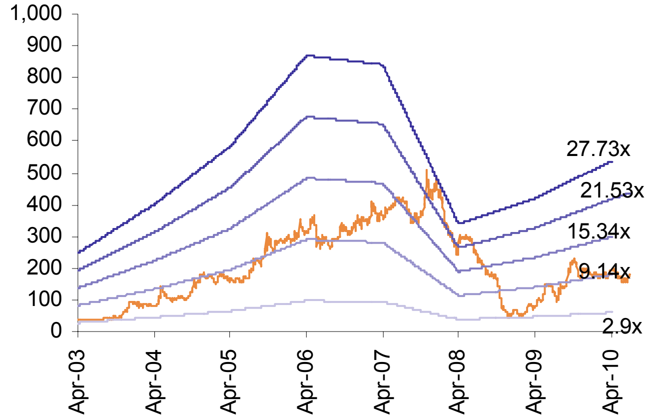
- Price hike by various automotive OEMs in the country might affect the sales on negative side.
- Slower than expected global recovery could impact future growth prospects and our earnings forecast

Valuations

Assigning a P/Ex of 11x to F6/11 EPS of Rs 19.3, we arrive at a target price of Rs 212, implying a potential upside of 18.4% from current levels.

Amtek Auto has a wide product portfolio with large client base. Further, the company has diversified into premium margin market through acquisitions in Europe and US. Its leadership position across large portfolio of products is expected to be the key revenue driver. We expect the company to witness a CAGR of 9% over F6/09-F6/12 in revenues. OPM, too are expected to improve to 25.1% in F6/11 and F6/12 each on back of enhanced margins at the overseas front coupled with the advantage of operating leverage. This will translate into an EPS of Rs19.3 for F6/11. We initiate coverage on the stock with a BUY rating and a target price of Rs212 for an investment horizon of 6-9 months. At our target price, the stock would trade at 11x F6/11E EPS of Rs19.3

P/E band



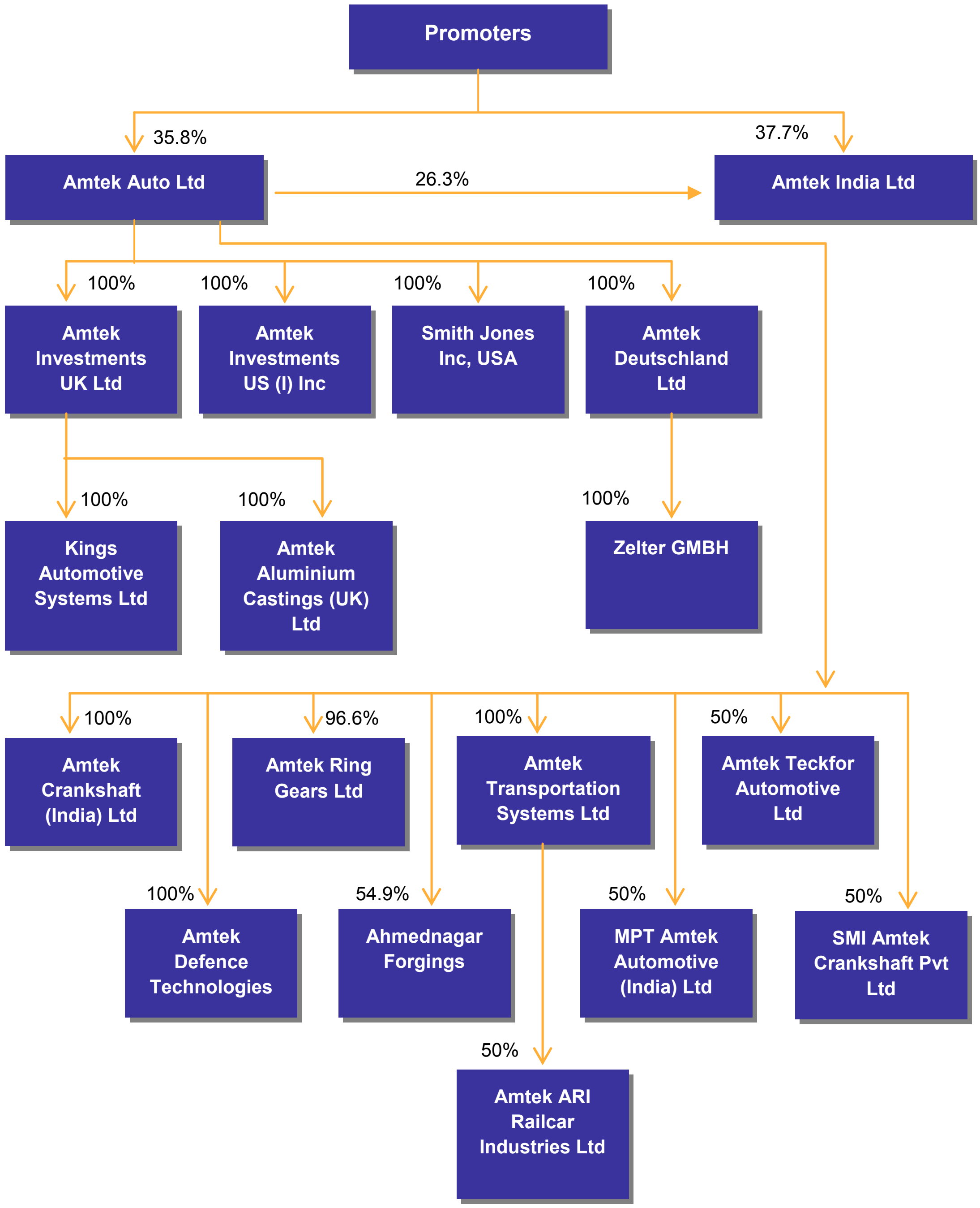
Source: Bloomberg, India Infoline Research

Board of Directors

Name	Designation
Arvind Dham	Chairman
D S Malik	ED
B Lugani	Non-Exec
Sanjay Chabbra	Non-Exec
Rajiv Thakur	Non-Exec
K Vaidyalingam	Non-Exec
John Ernest Flintham	Non-Exec

Source: Company

Company structure



Source: Company

Financials

Income statement

Y/e 31 Mar (Rs m)	F6/09	F6/10E	F6/11E	F6/12E
Revenue	34,386	36,636	40,483	44,531
Operating profit	**7,004**	**8,976**	**10,526**	**11,266**
Depreciation	(2,728)	(2,787)	(2,766)	(2,809)
Interest expense	(1,523)	(1,395)	(920)	(740)
Profit before tax	**2,753**	**4,794**	**6,840**	**7,717**
Taxes	(849)	(1,486)	(1,642)	(1,852)
Minorities and other	(176)	(265)	(416)	(469)
Net profit	**1,728**	**3,043**	**4,782**	**5,396**

Balance sheet

Y/e 31 Mar (Rs m)	F6/09	F6/10E	F6/11E	F6/12E
Equity capital	282	402	468	468
Share Apl. War.	499	0	0	0
Reserves	31,706	43,228	49,598	55,318
Net worth	**32,486**	**43,631**	**50,066**	**55,786**
Minority interest	2,226	2,490	2,906	3,375
Debt	38,981	31,000	25,543	20,543
Total liabilities	**73,693**	**77,121**	**78,515**	**79,704**
Fixed assets	49,080	47,293	45,527	43,717
Intangible assets	3,944	3,944	3,944	3,944
Investments	491	491	491	491
Net working capital	**12,197**	**14,984**	**15,500**	**16,044**
Inventories	7,554	6,625	7,320	8,052
Sundry debtors	5,220	6,324	6,987	7,686
Other current assets	10,173	10,173	10,173	10,173
Sundry creditors	(10,643)	(8,030)	(8,873)	(9,760)
Other current liabilities	(108)	(108)	(108)	(108)
Cash	7,981	10,409	13,053	15,508
Total assets	**73,693**	**77,121**	**78,515**	**79,704**

Cash flow statement

Y/e 31 Mar (Rs m)	F6/09	F6/10E	F6/11E	F6/12E
Profit before tax	2,753	4,794	6,840	7,717
Depreciation	2,728	2,787	2,766	2,809
Tax paid	(849)	(1,486)	(1,642)	(1,852)
Working capital Δ	(3,605)	(2,787)	(516)	(543)
Operating cashflow	1,027	3,308	7,448	8,131
Capital expenditure	(13,933)	(1,000)	(1,000)	(1,000)
Free cash flow	**(12,906)**	**2,308**	**6,448**	**7,131**
Equity raised	825	8,724	1,798	469
Investments	491	491	491	491
Debt fin./ dis.	9,989	(7,981)	(5,457)	(5,000)
Dividends paid	(88)	(125)	(145)	(145)
Other items	(145)	-	-	-
Net Δ in cash	**(1,834)**	**3,417**	**3,135**	**2,946**

Key ratios

Y/e 31 Mar	F6/09	F6/10E	F6/11E	F6/12E
Growth matrix (%)				
Revenue growth	(26.2)	6.5	10.5	10.0
Op profit growth	(27.0)	28.1	17.3	7.0
EBIT growth	(43.0)	44.7	25.4	9.0
Net profit growth	(59.6)	76.1	57.1	12.8
Profitability ratios (%)				
OPM	20.4	24.5	26.0	25.3
EBIT margin	12.4	16.9	19.2	19.0
Net profit margin	5.0	8.3	11.8	12.1
RoCE	6.3	8.2	10.0	10.7
RoNW	5.6	8.0	10.2	10.2
RoA	2.2	3.6	5.5	6.1
Per share ratios				
EPS	12.3	15.1	20.4	23.0
Dividend per share	0.0	0.0	0.0	0.0
Cash EPS	31.6	29.0	32.2	35.0
Book value per share	226.9	216.9	213.9	238.3
Valuation ratios				
P/E	14.6	11.8	8.8	7.8
P/CEPS	5.7	6.2	5.6	5.1
P/B	0.8	0.8	0.8	0.8
EV/EBIDTA	8.0	6.3	5.2	4.2
Payout (%)				
Dividend payout	5.1	4.1	3.0	2.7
Tax payout	30.8	31.0	24.0	24.0
Liquidity ratios				
Debtor days	55	63	63	63
Inventory days	80	66	66	66
Creditor days	113	80	80	80
Leverage ratios				
Interest coverage	2.8	4.4	8.4	11.4
Net debt / equity	1.0	0.5	0.2	0.1
Net debt / op. profit	4.4	2.3	1.2	0.4

Du-Pont Analysis

Y/e 31 Mar (Rs m)	F6/09	F6/10E	F6/11E	F6/12E
Tax burden (x)	0.63	0.63	0.70	0.70
Interest burden (x)	0.64	0.77	0.88	0.91
EBIT margin (x)	0.12	0.17	0.19	0.19
Asset turnover (x)	0.44	0.43	0.47	0.50
Financial leverage (x)	2.56	2.24	1.84	1.67
RoE (%)	**5.6**	**8.0**	**10.2**	**10.2**

Recommendation parameters for fundamental reports:

Buy – Absolute return of over +10%

Market Performer – Absolute return between -10% to +10%

Sell – Absolute return below -10%

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