7 May 2007

Automotive Axles

Rs574; Buy

Earnings Downgrade

Sector: Auto Ancillary

Target Price	**Rs703**
Market cap	Rs8.7 bn/US$213.3 mn
52-week range	Rs675/331
Shares in issue (mn)	15.1
6-mon avg daily vol (no of shares)	9,054
6-mon avg daily vol (mn)	Rs5.2/US$0.1
Bloomberg	ATXL IN
Reuters	ATOA.BO
BSE Sensex	13879
Website	www.autoaxles.com

Shareholding Pattern (%)

Promoters	71.0
FIIs	6.0
MFs/FIs/Banks	10.8
Public	6.6
Others	5.6

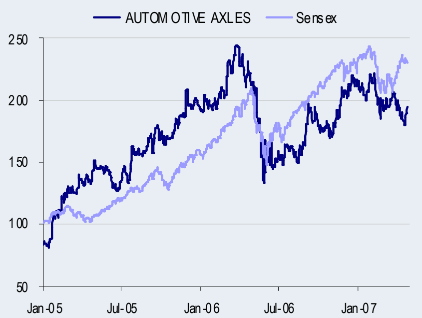
(As of 30 September 2007)

Price Performance (%)

	1M	3M	12M
Absolute	(4.8)	(7.3)	(12.1)
Relative*	(12.8)	(2.1)	(24.4)

**To the BSE Sensex*

Relative Performance



(As of 7 May 2007)

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Margin pressure - "an aberration"

Automotive Axles' (AAL) 2Q FY07 results were in-line with our expectation. Revenue witnessed a growth of 57% to Rs1.57 bn as against our expectation of Rs1.55 bn. Rise in raw materials cost by 9% QoQ (raw materials to sales increased by 270 bps YoY) led to margin pressure of 90 bps YoY to 17.1% (against our estimate of 18%). The reported PAT witnessed a growth of 40% to Rs143 mn, which includes an exchange income of Rs7.47 mn. When adjusted it leads to a PAT of Rs136 mn (inline with our estimated figure of Rs139 mn).

We believe that the margin pressure is temporary. The company would manage to increase its margins and maintain the same at 18% for 2H FY07, as it would be able to pass on the raw material hikes to its customers in the coming quarters.

On the back of lower than expected margins, we reduce our operating margin estimates for FY07E to 17.8% (EBITDA of Rs1.09 bn) from 18.4% and to 18.1% (EBITDA of Rs1.38 bn) from 18.8% for FY08E. Against this backdrop, we are reducing our PAT estimate by 4.2% to Rs587 mn, leading to an EPS of Rs38.8 for FY07E (earlier estimate of Rs40.8) and by 4.7% to Rs758 mn leading to an EPS of Rs50.2 for FY08E (earlier estimate of Rs52.9). Thus, we reduce the target price to Rs703, assigning 14x FY08E EPS of Rs50.2 (as against earlier target price Rs730). In spite of reduction in target price, the stock at the current price offers a potential upside of 22%. Thus we maintain our Buy rating. At the current price, it is trading at 11.4x FY08E EPS of Rs 50.2.

Highlights

- **Maintaining strong revenue growth:** ALL posted a top line growth of 57% to Rs1.55 bn backed by strong growth in CVs. However, higher raw materials cost led to a decline in operating profit margin by 90 bps YoY to 17.1%. The operating profit registered a growth of 49% to Rs269 mn. Despite higher interest burden and tax provisioning, the adjusted PAT registered a growth of 26% to Rs123 mn. Thus the adjusted EPS for the quarter is Rs8.1.

Exhibit 1: Financial summary (Rs mn)

Y/E September	FY05	FY06	FY07E	FY08E
Net sales	3,493	4,580	6,166	7,645
EBITDA	669	807	1,096	1,382
EBITDA (%)	19.2	17.6	17.8	18.1
Net Profit (Adj)	363	448	587	758
EPS (Rs)	24.4	29.7	38.8	50.2
EPS Growth (%)	(33.1)	21.6	30.9	29.2
ROCE (%)	48.9	46.2	45.8	47.8
ROE (%)	39.6	38.5	48.7	46.7
PE (x)	23.5	19.4	14.8	11.4
Price/Book Value (x)	10.7	8.5	6.1	4.4
EV/EBITDA (x)	12.6	10.4	7.7	5.7

Source: Company data, ASK Securities. Note: Valuations as of 7 May 2007.

- **Margin pressure of 90 bps YoY:** During 2Q FY07, the company had to bear the higher price of alloy steel at Rs64-65 per kg, a rise of 11% YoY. Also, the pass through effect of rise in raw material prices 1Q FY07 is yet to take place, which led to the margin fall for the quarter. For the next six months, we expect the company to post an average EBITDA margin of 18% as we expect the raw material price hike to be passed on to 2H FY07, which will lead to overall operating margin at 17.8% for FY07.

- **Capacity ramp up to augur growth:** The company's current capacity for gear sets is at 3,000 per month (exclusively for exports) which is 0.18 mn units per annum. For FY07E, the axles capacity is expected to reach 144,000 units and this is likely to increase by 20% in FY08E. The incremental capacity is expected to be completed by July 2007 and thus the benefit of operating leverage would accrue by FY08E.

- **Downgrading earnings estimates, revised price target to Rs703:** Against the backdrop of lower than expected margins, we reduce our operating margin estimates for FY07E to 17.8% (EBITDA of Rs1.09 bn) from 18.4% and to 18.1% (EBITDA of Rs1.38 bn) from 18.8% for FY08E. Against this backdrop, we are reducing our PAT estimate by 4.2% to Rs587 mn, leading to an EPS of Rs38.8 for FY07E (earlier estimate of Rs40.8) and by 4.7% to Rs758 mn leading to an EPS of Rs50.2 for FY08E (earlier estimate of Rs52.9). Thus, we reduce the target price to Rs703, assigning 14x FY08E EPS of Rs50.2 (as against earlier target price Rs730). In spite of reduction in target price, the stock at the current price offers a potential upside of 22%. Thus we maintain our Buy rating. At the current price, it is trading at 11.4x FY08E EPS of Rs 50.2.

Exhibit 2: Quarterly results **(Rs mn)**

Y/E September	2Q FY07	2Q FY06	% Chg	1H FY07	1H FY06	% Chg
Net Sales	**1,573**	**1,002**	**57.0**	**3,026**	**2,011**	**50.5**
Total Exp.	**1,303.8**	**821.9**	**58.6**	**2,506.7**	**1,648.4**	**52.1**
Raw Material Cost (a)	1,080	660	63.6	2,068	1,307	58.2
Staff cost (b)	68	54	24.4	133	109	21.6
Other Exp. (c)	157	108	45.5	307	233	31.7
Operating Profit	**269**	**180**	**49.6**	**520**	**363**	**43.3**
Interest	21	11	79.8	39	19	101.6
Depreciation	40	33	19.7	80	61	31.9
PBT before other income	**209**	**135**	**54.4**	**401**	**282**	**41.8**
Other Income	10	12	(22.4)	23	14	69.0
PBT	**219**	**148**	**48.0**	**424**	**296**	**43.1**
Tax	76	46	63.4	145	97	49.8
Effective tax rate (Tax/PBT)	***34.6***	***31.3***	***10.5***	***34.3***	***32.7***	***4.7***
Adjusted PAT	**143**	**101**	**40.9**	**278**	**199**	**39.8**
Adjusted EPS (Rs)	**9.5**	**6.8**	**40.9**	**18.6**	**13.3**	**39.8**
Reported PAT	**143**	**101**	**40.9**	**278**	**199**	**39.8**
Key Ratios (% to Sales)						
Raw Material Cost	68.6	65.9		68.3	65.0	
Staff Cost	4.3	5.4		4.4	5.4	
Other Expense	10.0	10.7		10.1	11.6	
Operating profit	17.1	18.0		17.2	18.0	

Source: Company data, ASK Securities

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